(19)

No. 96-454-CFX Title: Associates Commercial Corporation, Petitioner
v.
Elray Rash, et ux.

Docketed: September 24, 1996 Court: United States Court of Appeals for the Fifth Circuit

See also:
96-881

Entry	Date	Proceedings and Orders
	Sep 20 1996	Petition for writ of certiorari filed. (Response due October 24, 1996)
	Oct 21 1996	Brief amicus curiae of Hibernia National Bank filed.
	Oct 23 1996	Brief amicus curiae of United States filed.
	Nov 6 1996	DISTRIBUTED. November 27, 1996
	Nov 19 1996	Response requested.
	Dec 11 1996	Brief of respondents Elray Rash and Jean Rash in opposition filed.
	Dec 23 1996	Reply brief of petitioner Associates Commercial Corporation filed.
	Dec 30 1996	REDISTRIBUTED. January 17, 1997
	Jan 17 1997	Petition GRANTED. The brief of petitioner is to be filed with the Clerk and served upon opposing counsel on or before 3 p.m., Friday, February 28, 1997. The brief of respondents is to be filed with the Clerk and served upon opposing counsel on or before 3 p.m., Friday, March 28, 1997. A reply brief, if any, may be filed with the Clerk and served upon opposing counsel on or before 3 p.m., Wednesday, April 9, 1997. Rule 29.2 does not apply. SET FOR ARGUMENT April 16, 1997. **
	Jan 24 1997	Suggestion of mootness filed by respondents (TO BE RECOVERED).
	Feb 5 1997	Brief of petitioner in opposition to suggestion of mootness filed.
	Feb 10 1997	DISTRIBUTED. February 14, 1997 (Page 53)
	Feb 18 1997	Respondents' suggestion of mootness is rejected.
	Feb 26 1997	Brief amicus curiae of United States filed.
	Feb 28 1997	Joint appendix filed.
	Feb 28 1997	Brief of petitioner Associates Commercial Corporation filed.
	Feb 28 1997	Brief amici curiae of NationsBank, N.A., et al. filed.
	Feb 28 1997	Brief amici curiae of American Automobile Manufacturers Assn., et al. filed.
	Feb 28 1997	Brief amicus curiae of Washington Legal Foundation filed.
	Mar 6 1997	CIRCULATED.
	Mar 13 1997	Motion of the Acting Solicitor General for leave to participate in oral argument as amicus curiae and for divided argument filed.
	Mar 24 1997	Motion of the Acting Solicitor General for leave to participate in oral argument as amicus curiae and for divided argument GRANTED.
	Mar 26 1997	Brief amicus curiae of National Association of Chapter 13

2 pp

Entry	Date	Proceedings and Orders
		Trustees filed.
	Mar 26 1997	Brief amicus curiae of Donald And Madelaine Taffi filed.
	Mar 28 1997	Brief of respondents Elray Rash and Jean Rash filed.
	Mar 28 1997	Brief amicus curiae of National Association of Consumer Bankruptcy Attorneys, Inc. filed.
	Mar 31 1997	Motion of National Association of Consumer Bankruptcy Attorneys, Inc. for leave to participate in oral argument as amicus curiae and for divided argument filed.
	Apr 1 1997	Record filed.
	Apr 7 1997	Record filed.
	Apr 9 1997	Reply brief of petitioner Associates Commercial Corporation filed.
	Apr 11 1997	Motion of National Association of Consumer Bankruptcy Attorneys, Inc. for leave to participate in oral argument as amicus curiae and for divided argument DENIED.
	Apr 16 1997	ARGUED.

No. ———

In The
Supreme Court of the United States
October Term, 1996

Associates Commercial Corporation,
Petitioner,

v.

Elray Rash and Jean Rash,
Respondents.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

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PETITION FOR A WRIT OF CERTIORARI

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September 20, 1996

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QUESTION PRESENTED

Whether, when a debtor proposes to retain a secured creditor's collateral under the cramdown powers of chapter 13 of the Bankruptcy Code, the amount required to be paid on account of the creditor's secured claim is limited to the value that the secured creditor could have obtained if it had sold the collateral at foreclosure.

PARTIES

There are none other than the named parties herein.

LIST PURSUANT TO RULE 29.6

Petitioner is an 80%-owned subsidiary of Ford Motor Corporation.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1996

No. 96- ______

ASSOCIATES COMMERCIAL CORPORATION,
Petitioner,

v.

ELRAY RASH AND JEAN RASH,
Respondents.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

---

PETITION FOR A WRIT OF CERTIORARI

Petitioner respectfully requests that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Fifth Circuit entered in this case.

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Fifth Circuit sitting *en banc* was entered on July 30, 1996, is reported at 90 F.3d 1036, and is included in the Appendix at 1a-82a. The panel opinion of the Fifth Circuit was issued on September 13, 1994, is reported at 31 F.3d 325, and is included in the Appendix at 100a-109a. This opinion was modified on August 16, 1995, 62 F.3d 685, and, as modified, is included in the Appendix at 89a-99a. The unreported opinion of the United States District

Court for the Eastern District of Texas was issued on September 15, 1993, and is included in the Appendix at 83a-88a. The opinion of the United States Bankruptcy Court for the Eastern District of Texas was issued on January 11, 1993, is reported at 149 B.R. 430, and is included in the Appendix at 110a-119a.

JURISDICTION

The opinion and judgment of the court of appeals was entered on July 30, 1996. This Court has jurisdiction pursuant to 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

11 U.S.C. § 506(a) provides:

> (a) An allowed claim of a creditor secured by a lien on property in which the estate has an interest, or that is subject to setoff under section 553 of this title, is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property, or to the extent of the amount subject to setoff, as the case may be, and is an unsecured claim to the extent that the value of such creditor's interest or the amount so subject to setoff is less than the amount of such allowed claim. Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor's interest.

11 U.S.C. § 1325(a)(5) provides:

> (a) Except as provided in subsection (b), the court shall confirm a plan if—
>
> * * *
>
> (5) with respect to each allowed secured claim provided for by the plan—
>
> (A) the holder of such claim has accepted the plan;

> (B)(i) the plan provides that the holder of such claim retain the lien securing such claim; and
>
> (ii) the value, as of the effective date of the plan, of property to be distributed under the plan on account of such claim is not less than the allowed amount of such claim; or
>
> (C) the debtor surrenders the property securing such claim to such holder . . .

STATEMENT OF THE CASE

This case presents an important and recurring issue as to the respective rights of chapter 13 debtors and their secured creditors, which has divided several courts of appeals. Specifically, at issue here is the standard for determining the amount that a debtor is required to pay to his secured creditors when he seeks to retain their collateral, over their objection, in a chapter 13 plan. Is the debtor required, as the court below held, to pay the secured creditor only that amount which the creditor could have received if it had sold the collateral at foreclosure, or is the debtor required, as three other circuits have held, to pay the value of the collateral as used by the debtor for the purposes contemplated in the plan (*i.e.*, fair market or retail value)?

Some 250,000 chapter 13 cases are filed each year, and, because the vast majority of debtors have secured loans, the issue presented is likely to arise in most of them, with a resulting annual aggregate economic impact in the hundreds of millions of dollars. Moreover, the question is a fundamental one in bankruptcy, which the court below itself recognized requires a national uniform rule. Only this Court can provide that uniformity.

FACTUAL AND PROCEDURAL BACKGROUND

1. Respondent Elray Rash derives his income from a Kenworth T600A tractor truck that he purchased on credit in 1989 and uses in his freight-hauling business.

App. 110a. Petitioner Associates Commercial Corporation ("Associates") provided financing and holds a lien on the truck. In 1992, respondents Rash and his wife Jean filed a joint petition under chapter 13 of the Bankruptcy Code, together with a plan that provided that he would keep the truck and continue operating his freight-hauling business. The plan recognized that petitioner had a valid security interest in the truck, but purported to limit the amount of petitioner's secured claim to the truck's wholesale value.

The sole relevant issue before the bankruptcy court was the appropriate standard for valuing the truck as collateral. The court framed the issue as follows:

> Associates maintains that the truck should be valued according to its retail value i.e. what the Debtor would be required to pay to replace it. Debtor disagrees, arguing that the appropriate standard of valuation should be the wholesale value of the truck i.e. what the truck is worth to the dealer. The testimony indicates that . . . the truck has a wholesale value of $31,875.00 and a retail value of $42,500.00. App. 111a.

The bankruptcy court viewed the issue before it as a pure question of law—whether retail value or wholesale value is the appropriate standard of valuation when a debtor proposes to "cram down" a plan over a secured creditor's objection. The court concluded that 11 U.S.C. § 506(a) requires a wholesale valuation, and stated that "wholesale value most often equates to the value in the hands of the creditor after he has deducted his foreclosure and disposition costs so that it is a reasonable indication of the net proceeds he will receive upon the disposition of the reclaimed collateral." App. 113a.

The bankruptcy court then confirmed a chapter 13 plan over petitioner's objection. The plan was premised on allowing Associates a secured claim in the amount of the truck's wholesale value, to be paid in 58 monthly installments (with interest). Thus, the respondents need only pay $31,875, rather than the entire loan balance of $41,171, to discharge petitioner's security interest. Respondents are leasing the truck to a third party for about $1,200 per week, while paying Associates about $158 per week under the plan. App. 87a.

2. Associates timely appealed the final order approving confirmation of the chapter 13 plan to the United States District Court for the Eastern District of Texas. Exercising jurisdiction under 28 U.S.C. §§ 157 and 1334, that court affirmed. App. 83a-88a.

A panel of the Court of Appeals for the Fifth Circuit reversed. App. 100a-109a. The panel concluded that "replacement value" rather than "foreclosure value" is required by the plain meaning of § 506(a).[1] A petition for rehearing *en banc* was granted. In the meantime, the First, Eighth and Ninth Circuits issued decisions agreeing with the panel below. Nevertheless, by a vote of 9-6 (with Judges Jones, Garwood and Higginbotham recusing themselves), the *en banc* court overturned the panel decision, rejected the holdings of the other circuits, and held that petitioner's secured claim was limited to the wholesale value of its collateral. The majority ruled that "[u]ltimately, it is the creditor's interest that is being valued under § 506(a), and such valuation must account for the fact that the creditor's interest is in the nature of a security interest, giving the creditor the right to repossess and sell the collateral and nothing more. Therefore, the valuation should start with what the creditor could realize by exercising that right." App. 14a.

As the dissent below pointed out, the majority's interpretation of § 506(a) "has been squarely rejected by

[1] As recognized by the *en banc* majority, "replacement value" in the context of respondents' truck means the value of a *comparable* truck of similar age, mileage and operating condition, not the value of a *new* truck of the same make and model. App. 8a n.3. This is equivalent to the fair market value of the truck to the debtor.

every other circuit that has considered it. . . . Section 506(a) . . . plainly means that when a reorganizing debtor retains and uses collateral, we must value the property according to its worth to the debtor (the actual user), not to the creditor (a purely hypothetical seller)." App. 52a (Smith, J., dissenting).

REASONS FOR GRANTING THE PETITION

The decision below creates an acknowledged conflict among the circuits as to an issue that is fundamental to the administration of the Bankruptcy Code, *viz.*, what value must be paid on account of a secured claim if the debtor keeps the collateral? The majority itself observed that this issue "has substantial economic impact . . . on all Chapter 13 debtors and their creditors. . . ." App. 50a. The *en banc* decision not only departs from the views of the other courts of appeals, but is contrary to the plain statutory language and this Court's approach to § 506 in *United Savings Ass'n* v. *Timbers of Inwood Forest Assocs.*, 484 U.S. 365 (1988), *Dewsnup* v. *Timm*, 502 U.S. 410 (1992), and *Nobelman* v. *American Savings Bank*, 508 U.S. 324 (1993). For these reasons, this case merits review by this Court to ensure a uniform interpretation of 11 U.S.C. § 506(a).

I. THE DECISION BELOW CONFLICTS WITH THE DECISIONS OF OTHER COURTS OF APPEALS AND OF THIS COURT

1. *Conflict Among the Circuits.* The *en banc* majority held that a chapter 13 debtor may keep a secured creditor's collateral if it pays the creditor the amount the creditor would realize from a hypothetical foreclosure sale. This holding is squarely contrary to the decisions and reasoning of the First, Fourth, Sixth, Eighth, and Ninth Circuits, which have held that the correct valuation standard is the value of the collateral as used by the debtor—that is, the fair market value of the collateral or, alternatively, the cost to the debtor of replacing the collateral with equivalent property. The court below

recognized the conflict, but stated that "[w]e cannot join our sister circuits" because they were "incorrect" on the issue and because of the "substantial economic impact" of the issue. App. 50a.

Even as this petition was being finally prepared for filing, the argument in favor of certiorari became overwhelming as the Ninth Circuit issued its *en banc* decision on September 17, 1996, in *Taffi* v. *United States* (*In re Taffi*), Nos. 94-55011 & 94-55019, slip op. (9th Cir. Sept. 17, 1996) (*en banc*). The *en banc* court *unanimously* overruled its own precedent to "put this circuit in harmony with all other circuits, except the Fifth, that have considered the question. . . ." *Taffi* v. *United States* (*In re Taffi*), Nos. 94-55011 & 94-55019, slip op. at 7 (9th Cir. Sept. 17, 1996) (*en banc*). The *en banc* court stated:

> When a Chapter 11 debtor or a Chapter 13 debtor intends to retain property subject to a lien, the purpose of a valuation under section 506(a) is not to determine the amount the creditor would receive if it hypothetically had to foreclose and sell the collateral. Neither the foreclosure value nor the costs of repossession are to be considered because no foreclosure is intended. Instead, when the proposed use of the property is continued retention by the debtor, . . . the value has to be the fair market value of what the debtors are using. *Id.* at 5-6.

Also contrary to the decision below are the Eighth Circuit's holding in *Metrobank* v. *Trimble* (*In re Trimble*), 50 F.3d 530, 531 (8th Cir. 1995), which agreed with the original panel's opinion in this case that "the retail valuation method is the only method that gives full effect to the entire language of section 506(a)," and the First Circuit's holding in *Winthrop Old Farm Nurseries, Inc.* v. *New Bedford Institution for Savings* (*In re Winthrop Old Farm Nurseries, Inc.*), 50 F.3d 72, 75 (1st Cir. 1995), which refused to use a foreclosure standard of valuation in a chapter 11 case where the debtor proposed to keep the collateral.

In addition, the decision below that § 506(a) requires a foreclosure standard of valuation is contrary to the holding of other courts of appeals regarding foreclosure costs. Like *Taffi*, these cases reject the foreclosure standard, holding that when a debtor proposes to keep the collateral, the amount of a secured creditor's claim under § 506(a) should not be reduced by the hypothetical costs of a foreclosure sale. *Huntington Nat'l Bank* v. *Pees (In re McClurkin)*, 31 F.3d 401, 405 (6th Cir. 1994); *Coker* v. *Sovran Equity Mortgage Co. (In re Coker)*, 973 F.2d 258, 260 (4th Cir. 1992); *Brown & Co. Sec. Corp.* v. *Balbus (In re Balbus)*, 933 F.2d 246, 251-52 (4th Cir. 1991). While subsumed within the broader question presented, this related conflict in decisions reinforces the importance of review of this case by the Court.

In sum, there is now a completely irreconcilable conflict between *en banc* decisions of two different circuits, as well as panel decisions of four other circuits. There can no longer be any doubt that certiorari is appropriate in this case.

2. *Plain Meaning of the Statute*. The six judges who dissented below, together with the other courts of appeals that have considered this question, have all found the plain language of the statute to be dispositive and favorable to the secured creditor.

Section 506(a) of the Bankruptcy Code contains two sentences that specify how the amount of a secured claim is to be determined. The first sentence establishes that the amount of a secured claim is equal to "the value of such creditor's interest in the estate's interest in such property." The second sentence specifies that "[s]uch value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor's interest."

Thus, the first sentence "tells us only that the amount of a secured claim is the value of the collateral; it does

not tell us how to determine that value." App. 52a (Smith, J., dissenting). The majority below, however, discerned in the first sentence of § 506(a) a requirement that a court focus on what the creditor otherwise could realize through foreclosure. App. 13a-14a. But the first sentence addresses only *what* is to be valued, and not *how* it is to be valued. As this Court has pointed out, "[t]he phrase 'value of such creditor's interest' in § 506(a) means 'the value of the collateral.'" *United Sav. Ass'n* v. *Timbers of Inwood Forest Assocs.*, 484 U.S. 365, 372 (1988). Of course, the value of property *to the debtor* may differ from its value *to the creditor*. The first sentence of § 506(a) simply provides no guidance as to which measure of valuation is the proper one.

That guidance is provided by the second sentence of § 506(a), which dictates that "value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property." The language here is mandatory. It states how value "shall be determined," and does not merely list factors that the court *may* choose to consider. For a number of reasons, the majority's interpretation cannot be reconciled with the plain meaning of this sentence.

The statute clearly distinguishes for valuation purposes between a "proposed disposition" and a "proposed . . . use" of property. When collateral is to be surrendered to the creditor pursuant to § 1325(a)(5)(C), that is a "proposed disposition," and the value of the secured claim can appropriately be measured by the value of the collateral to the creditor. But in this case, there was no such disposition. Rather, the plan provides that Rash will keep the truck for his business. This is a "use" *by the debtor*—and the only way to read the statute coherently is to value the truck in accordance with the debtor's proposed use. The majority below, by contrast, treats the "proposed . . . use" by the debtor under the plan as irrelevant, and instead values the collateral based on a hypothetical "dis-

position" by Associates, which the plan does not propose. This interpretation ignores the statutory distinction between "use" and "disposition." The statute does not allow debtors to "use" the property while paying only "disposition" value. "If the 'proposed use or disposition' provision is to have any meaning, the debtor should not be permitted to 'eat with the hounds and run with the hares.'" *Coker* v. *Sovran Equity Mortgage Co. (In re Coker)*, 973 F.2d 258, 260 (4th Cir. 1992).

The majority's interpretation also renders the second sentence meaningless. "Under the wholesale valuation method, the creditor's interest would always be valued at the amount the creditor would receive upon disposition of the collateral, regardless of the purpose of the valuation or of the proposed disposition or use of the property." *Metrobank* v. *Trimble (In re Trimble)*, 50 F.3d 530, 532 (8th Cir. 1995). As Chief Judge Wallace pointed out for the Ninth Circuit panel in *Taffi*, "there is no reason to reduce the amount of an already undersecured claim to the forced sale value of the property at the time of the plan's approval, when no forced sale is contemplated." *Taffi* v. *United States (In re Taffi)*, 68 F.3d 306, 308 (9th Cir. 1995), *aff'd on reh'g en banc*, Nos. 94-55011 & 94-55019, slip op. (9th Cir. Sept. 17, 1996). A "foreclosure value" standard differs so markedly from other valuation standards—such as "fair market value," see *BFP* v. *Resolution Trust Corp.*, 511 U.S. 531, 114 S. Ct. 1757 (1994)—that Congress surely would have been more specific if it had meant to limit a secured creditor's claim to foreclosure value.

Moreover, the phrase requiring consideration of "the purpose of the valuation" would also be surplusage if the majority's view were correct. If a foreclosure standard must be applied at the *plan confirmation stage* of a bankruptcy case, when the debtor has decided ultimately to keep the collateral, then it is hard to imagine any other stage of the case or any other purpose for which a different measure of value would prevail.

In effect, therefore, the majority's holding reads the second sentence of § 506(a) out of the Bankruptcy Code, and therefore fails the requirement that "a statute must, if possible, be construed in such fashion that every word has some operative effect." *United States* v. *Nordic Village, Inc.*, 503 U.S. 30, 36 (1992). All of the other courts of appeals that have interpreted this language have declined to follow the Fifth Circuit's approach. This divergence in approach among the courts of appeals warrants review by this Court.

3. *The Majority's Erroneous View of State Law.* The majority erroneously concluded that it could not accept the interpretation of § 506(a) adopted by other circuits because, in its view, state law limits the creditor's recovery to foreclosure value, and the statute does not contain "the 'clear textual guidance' needed to justify the departure from state law effected by a replacement cost valuation." App. 22a. The court reasoned that the phrase "creditor's interest in the estate's interest in such property" in the first sentence of § 506(a) looks to state law not only to determine *what* property is subject to the lien, but also to determine the property's value based on the *remedies* available for enforcing the lien.

The majority's reading of § 506(a)—which would value a security interest by examining the state-law remedies purportedly available to the creditor—is precluded by this Court's decision in *United Savings Ass'n* v. *Timbers of Inwood Forest Assocs.*, 484 U.S. 365 (1988). This Court pointed out that under § 506(a), "the creditor's 'interest in property' obviously means his security interest without taking account of his right to immediate possession of the collateral on default." *Id.* at 372. Thus, *Timbers* teaches that state-law foreclosure remedies do not determine the value of the "creditor's interest" under § 506(a).

The court below also erred in demanding "clear textual guidance" before it could interpret § 506(a) in a way

that purportedly departs from state law. There is simply no state-law counterpart to this provision. The purpose of § 506(a) is to bifurcate the secured creditor's claim into a secured portion and an unsecured portion for purposes of applying various provisions of the Bankruptcy Code. See *United States* v. *Ron Pair Enters., Inc.*, 489 U.S. 235, 239 n.3 (1989). The § 506(a) valuation at issue here was conducted in the context of a so-called "cram-down" plan under § 1325(a)(5)(B), pursuant to which a chapter 13 debtor may retain the collateral of a secured creditor over its objection so long as, among other things, "the value, as of the effective date of the plan, of [such] property . . . is not less than the allowed amount of [the secured] claim." The concept of bifurcating a claim (and valuing the secured portion), particularly for purposes of permitting a debtor to keep collateral without the secured creditor's consent, is peculiar to federal bankruptcy law. It has no state-law analogue, and consequently there is no basis for invoking the "clear textual guidance" canon of construction.[2]

[2] This case thus stands in stark contrast to *BFP* v. *Resolution Trust Corp.*, 511 U.S. 531, 114 S. Ct. 1757 (1994), where this Court demanded "clearer textual guidance" before it would give the fraudulent transfer provision of the Bankruptcy Code, § 548, an interpretation that is "a radical departure" from the interpretation given to other fraudulent transfer statutes that have been a part of Anglo-American jurisprudence for over 400 years. 114 S. Ct. at 1764. Here, unlike *BFP*, there is no provision of state law comparable to § 506(a).

The use of a fair market or retail value standard in this case is perfectly consistent with both the majority and dissenting opinions in *BFP*. The Court held that in determining whether the price received at a foreclosure sale is "reasonably equivalent value," the very fact that the property is being sold at foreclosure must be taken into account. Likewise, in the present case, the fact that the truck will be used by the debtor, instead of being disposed of by foreclosure, must be taken into account. Similarly, the dissent in *BFP* acknowledged that the term "value" in the Bankruptcy Code typically means "fair market value" rather than forced sale or liquidation value, as suggested by the majority opinion below: "The term of choice in the bankruptcy setting seems to be 'value,' unadorned and undefined, which appears in more than 30 sections of the Bankruptcy Code, but which is, with respect to many of them, read to mean 'fair market value.'" *Id.* at 1768 n.1 (Souter, J., dissenting).

In any event, the majority misconstrued state law when it declared that the creditor's only right is "to repossess and sell the collateral and nothing more." App. 14a. Under state law, the creditor has a right to be paid in full. The debtor has no right to keep the collateral after a default unless he pays the debt. See, *e.g.*, Uniform Commercial Code § 9-506, as adopted in Texas, Tex. Bus. & Com. Code Ann. § 9.506 (debtor in default may redeem collateral upon "tendering fulfillment of all obligations secured by the collateral").[3]

Under the majority's holding, by contrast, not only can a debtor retain its collateral by paying less than the amount of its debt, but he is not even required to pay what it would cost him to purchase comparable property elsewhere. There is certainly nothing in state law which gives debtors a general dispensation to purchase their vehicles at wholesale when all other citizens must pay retail—and nothing in state law to suggest that the rule should be different when the vehicle is purchased from a secured creditor.

Thus, "the value of such creditor's interest" is not limited by state law to foreclosure value. People usually want to *avoid* foreclosure, particularly of their homes and vehicles, and thus usually make every effort to pay their secured loans. A lien therefore can have a value (in

[3] Even if the creditor forecloses, it is not limited by *state law* to the recovery of wholesale value. For example, the creditor itself will often purchase the property by credit bid at the foreclosure sale, Uniform Commercial Code § 9-504(3), and retain the asset for resale at whatever price it desires—including a possible sale to the debtor, who presumably would be willing to pay up to the retail value for the property.

encouraging payment of the debt) that is more accurately measured by the value of the property to the debtor, rather than its foreclosure value.

In sum, the majority's reliance on state law is misplaced. Once that linchpin error is corrected, the sole legal issue is the proper interpretation of § 506(a), which, as demonstrated above, the dissent and the other circuits have more properly construed than the majority below.

4. *Conflict with the Decisions of this Court.* Although this Court has never addressed the precise issue presented in this case, the essential reasoning of three prior decisions is contrary to the conclusion of the *en banc* majority that the valuation of a secured claim under § 506(a) must be based on a hypothetical repossession or foreclosure. As noted earlier, *United Savings Ass'n* v. *Timbers of Inwood Forest Assocs.*, 484 U.S. 365, 372 (1988), *rejected* the idea that a state-law "right to immediate possession on default" is relevant to valuing the secured creditor's claim under § 506(a).

In addition, the majority's effort to enhance the position of debtors at the expense of their secured creditors is contrary to this Court's reasoning in *Dewsnup* v. *Timm*, 502 U.S. 410 (1992). In *Dewsnup*, this Court interpreted the phrase "allowed secured claim" in § 506(d) as having a different meaning than the same phrase in § 506(a), to prevent a debtor's benefitting from retaining collateral at the expense of its secured creditor by "stripping-down" the creditor's lien. 502 U.S. at 417. This Court reasoned that "[a]ny increase over the judicially determined valuation during bankruptcy rightly accrues to the benefit of the creditor," *id.*, and recognized that apart from reorganization proceedings, "no provision of the pre-Code statute permitted involuntary reduction of the amount of a creditor's lien for any reason other than payment on the debt." *id.* at 418-19. *Dewsnup*'s approach of preserving secured creditor's traditional rights

is thus diametrically opposed to the *en banc* majority's effort to narrow those rights, and to allow the debtor to retain any surplus value over what the creditor could obtain through foreclosure.

Finally, in *Nobelman* v. *American Savings Bank*, 508 U.S. 324, 326 (1993), a case involving a chapter 13 plan that allowed the debtors to keep their home, this Court stated that the mortgagee's claim was equal to "the fair market value of the mortgaged residence." There was no suggestion by the Court in *Nobelman* that § 506(a) required a foreclosure standard of valuation.

II. THE ISSUES HERE PRESENTED ARE OF SUBSTANTIAL ECONOMIC IMPORTANCE

In 1995, over 286,000 chapter 13 petitions were filed; almost 250,000 such cases were filed in 1994. Bankruptcy Statistical Information, *reprinted in* 1995 Admin. Off. of U.S. Cts., JCUS Rep. 93, Table F-2; 1994 Admin. Off. of U.S. Cts., JCUS Rep. 93, Table F-2. Most of these cases undoubtedly involve debtors with cars, trucks, appliances, and other assets that were purchased on credit. Indeed, a principal reason why debtors choose to file under chapter 13 rather than liquidate under chapter 7 is that they hope to retain such property. The difference between valuing such assets at wholesale rather than retail will have an immediate and substantial economic impact upon debtors and creditors in a vast number of chapter 13 cases.

Moreover, the logic of the *en banc* decision may extend to reorganizations under chapter 11 and adjustments of debts of family farmers under chapter 12 of the Bankruptcy Code. Although the majority makes an effort to distinguish chapter 13 cases and business reorganizations under chapter 11, App. 34a n.23, its statutory analysis is rooted in § 506(a), which applies to cases brought under all the chapters of the Bankruptcy Code, and not just chapter 13. 11 U.S.C. § 103(a). Thus, the decision

below could have significant consequences in all bankruptcy cases. Given the importance of the issue, review by this Court would be warranted even without a conflict among the circuits. In light of the decisional conflict, certiorari is unquestionably appropriate.

* * * *

As Judge Smith argued below in dissent, the majority's "policy-driven reconstruction of [§ 506(a)] has been squarely rejected by every other circuit that has considered it." App. 52a (Smith, J., dissenting). The identical truck simply cannot have a far different value solely depending upon whether the bankruptcy proceeding arises in Texas or Massachusetts. The need for a uniform rule in this context is unusually compelling. Endless further litigation on this issue in chapter 13 proceedings is unquestionably wasteful of limited resources, and only this Court can put an end to this dispute. Accordingly, the Court should grant review of this case and resolve the meaning of 11 U.S.C. § 506(a).

CONCLUSION

The petition for certiorari should be granted.

Respectfully submitted,

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September 20, 1996

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APPENDICES

APPENDIX A

[Filed Jul. 30, 1996]

IN THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

No. 93-5396

IN THE MATTER OF: ELRAY and JEAN RASH,
Debtor.

ASSOCIATES COMMERCIAL CORPORATION,
Appellant,

v.

ELRAY RASH and JEAN E. RASH,
Appellees.

Appeal from the United States District Court
for the Eastern District of Texas

Before POLITZ, Chief Judge, and REYNALDO G. GARZA, KING, JOLLY, DAVIS, SMITH, DUHE, WIENER, BARKSDALE, EMILIO, M. GARZA, DEMOSS, BENAVIDES, STEWART, PARKER, and DENNIS, Circuit Judges.

* Judges Garwood, Higginbotham, and Jones are recused and did not participate in this decision.

KING, Circuit Judge:

A creditor appeals the district court's affirmance of the bankruptcy court's orders that fixed the amount of the creditor's secured claim and confirmed the debtors' amended Chapter 13 plan. The debtors' plan treated the creditor's secured claim under the "cram down" provision found in § 1325(a)(5)(B) of the Bankruptcy Code: the debtors would retain the collateral securing the creditor's lien—a tractor truck—and pay the creditor the amount of its secured claim, such amount being equal to the value of the truck. Following an evidentiary hearing, the bankruptcy court determined that the value of the truck for purposes of cram down was the amount that the creditor could realize if it repossessed and sold the truck according to the security agreement; the court then found that this amount was the truck's wholesale price. The creditor urges on appeal that, as a matter of law, the truck's value for cram down purposes is equal to its "replacement cost," or, what it would cost the debtors to purchase an identical vehicle; the creditor suggests that, on this record, the truck's replacement cost is its retail price. We do not agree that the Bankruptcy Code compels this result as a matter of law. Accordingly, we affirm the courts below.

I. FACTUAL AND PROCEDURAL BACKGROUND

On March 30, 1989, Elray Rash purchased a Kenworth tractor truck from Janoe Truck Sales & Service, Inc., d/b/a Janoe Kenworth Trucks. The cash price of the truck was $73,700. Rash made a down payment of $16,011 by trading in the truck he then owned and agreed to pay the remaining balance and finance charges in sixty monthly installments of $1,610.41. To secure payment of the unpaid balance, Janoe retained a lien on the truck. Janoe assigned this lien and its other rights under the sales agreement to Associates Commercial Corporation ("ACC"). Since the date of purchase, Rash has continued to own and operate the truck as part of his freight hauling business, which is the primary source of income for his family.

In March 1992, Rash and his wife Jean E. Rash (collectively, the "Rashes") filed a joint petition and a plan under Chapter 13 of the United States Bankruptcy Code. The petition stated that the amount of ACC's secured claim—i.e., the value of the truck—was $28,500. The plan provided that the Rashes would keep the truck and that ACC's secured claim would be treated under the "cram down" option found in § 1325(a)(5)(B) of the Bankruptcy Code, 11 U.S.C. § 1325(a)(5)(B). Pursuant to this option, ACC would retain its lien and receive payments over the life of the plan, the present value of which equaled the amount of its secured claim: $607.79 per month for fifty-eight months, for a principal total of $28,500 and interest at nine percent. If ACC claimed more than this amount, the plan treated the excess as an unsecured claim to be paid pro rata with the other unsecured claims after all priority and secured debts had been paid.

ACC then filed a proof of claim and a motion for relief from the automatic stay. In its proof of claim, ACC alleged that it had a fully secured claim in the amount of $41,171.01. In response, the Rashes filed an objection to ACC's claim, asserting that the value of the truck was $28,500. Accordingly, the Rashes maintained that only $28,500 of ACC's claim was secured and that the balance was unsecured; however, the Rashes did not dispute the total amount of the claim.

On June 16, 1992, the Bankruptcy court held a hearing on, inter alia, the Rashes' objection to ACC's claim and ACC's motion for relief from the automatic stay. The court heard the Rashes' objection and ACC's motion together because the disposition of each required the court to determine the value of the truck. ACC's expert witness on the valuation issue was Dirk Copple, a twenty-four-year-old collections manager for ACC. Copple opined that the truck's "current market value"—a term that he defined as the fair value paid by an average in-

dividual who walked off the street into a dealership—was $41,000. Copple admitted that he had never seen the Rashes' truck; rather, he based his opinion on his own experience, his conversations with a couple of dealerships, software used by ACC to "book out" equipment, and the industry blue book. Regarding his experience, Copple testified that he had never bought or sold trucks in the open market and that ACC was not a truck dealer, but that he had conducted between fifteen and twenty-five foreclosure sales of trucks in his two years at ACC. Assuming a figure of fifteen sales, Copple testified that ACC had purchased the trucks at twelve of the sales. ACC offered no evidence as to what it did with these trucks after purchasing them. With respect to the other three sales, Copple testified that the purchasers paid at least ninety-two percent of the trucks' retail price; however, Copple also admitted that bidders other than ACC typically offered only seventy-five percent of the retail price.

The Rashes' expert witness was Steven Thibodeaux, a thirty-two-year-old salesperson for Smart's Truck and Trailer, a local dealership that sells new and used trucks. Thibodeaux testified that he had worked at Smart's for ten years and had bought and sold all types of trucks during that period.[1] Thibodeaux opined that the truck's value was $31,875. In support of this opinion, Thibodeaux testified that he had (1) conducted a complete inspection of the Rashes' truck, (2) calculated the truck's retail price to be $42,500 by reference to the industry blue book, and (3) deducted twenty-five percent from the retail price to arrive at a wholesale price of $31,875. Thibodeaux stated that, as a dealer, he would not pay more than this amount if the Rashes or ACC tried to sell the truck to Smart's. Later, Thibodeaux elaborated that he could not make a profit if he paid the retail price

[1] Although Smart's is a GMC dealership, Thibodeaux testified that Smart's carried Kenworth trucks on its used lot from time to time.

of the truck because of the additional costs incurred by a dealer, including reconditioning the truck for resale and paying a salesperson's commission.

On January 11, 1993, the bankruptcy court entered an order denying ACC's motion for relief from the automatic stay[2] and fixing the amount of ACC's secured claim at the truck's wholesale price of $31,875. In an accompanying opinion, the court reasoned that it had to calculate the value of the truck from the "creditor's perspective" because § 506(a) of the Bankruptcy Code sets the amount of a secured claim at "the value of [the] *creditor's interest* in the estate's interest in the property." *In re Rash*, 149 B.R. 430, 433 (Bankr. E.D. Tex. 1993) (quoting 11 U.S.C § 506(a)) (emphasis added). Accordingly, the court determined that the value of the truck was equal to the amount that ACC could realize if it exercised its right under the security agreement to repossess and sell the truck. *Id.* Based on the evidence presented at the hearing, the court found that this amount was the truck's wholesale price. *Id.* at 434. The court noted that this value was not affected by the fact that the Rashes were keeping the truck "because from the creditor's perspective, his net result, in the event of future repossession or foreclosure, will be the same." *Id.* at 433.

In response to the January 11 order, the Rashes amended their plan to increase the amount of ACC's secured claim from $28,500 to $31,875. The bankruptcy court then entered another order confirming this amended plan. ACC appealed both orders. The district court consolidated the appeals and affirmed the decisions of the

[2] The court denied the motion for relief from the stay predicated on § 362(d)(2) of the Bankruptcy Code because, although the Rashes had no equity in the truck, the Rashes' continued use of the truck was necessary for a successful reorganization. *In re Rash*, 149 B.R. 430, 434 (Bankr. E.D. Tex. 1993). Further, the court denied the motion predicated on § 362(d)(1) because the evidence showed that the truck was both insured and maintained. *Id.*

bankruptcy court. A panel of this court reversed, holding that the appropriate measure of the truck's value was its replacement cost to the Rashes, which the panel determined to be the truck's retail price. *Associates Commercial Corp. v. Rash (In re Rash),* 31 F.3d 325, 329 (5th Cir. 1994), *modified,* 62 F.3d 685 (5th Cir. 1995). We granted rehearing en banc to determine whether the bankruptcy court erred, as a matter of law, in failing to value the Rashes' truck at its replacement cost. 68 F.3d 113 (5th Cir. 1995).

II. STANDARD OF REVIEW

Although the bankruptcy appellate process makes this court the second level of review, we perform the identical task as the district court. *Heartland Fed. Sav. & Loan Ass'n v. Briscoe Enters., Ltd., II (In re Briscoe Enters., Ltd., II),* 994 F.2d 1160, 1163 (5th Cir.), *cert. denied,* 114 S. Ct. 550 (1993). We review findings of fact by the bankruptcy court under the clearly erroneous standard and decide issues of law de novo. *Henderson v. Belknap (In re Henderson),* 18 F.3d 1305, 1307 (5th Cir.), *cert. denied,* 115 S. Ct. 573 (1994); *Haber Oil Co. v. Swinehart (In re Haber Oil Co.),* 12 F.3d 426, 434 (5th Cir. 1994). We are aided here by excellent opinions from the bankruptcy court and the district court.

III. DISCUSSION

A. Statutory Framework

Section 1325(a) of the Bankruptcy Code, 11 U.S.C. § 1325(a), sets forth six prerequisites to confirmation of a Chapter 13 plan. The requirement at issue in this case, § 1325(a)(5), concerns the plan's treatment of allowed secured claim. That provision states in relevant part:

> [T]he court shall confirm a plan if—
>
> . . . .
>
> (5) with respect to each allowed secured claim provided for by the plan—

> (A) the holder of such claim has accepted the plan;
>
> (B)(i) the plan provides that the holder of such claim retain the lien securing such claim; and
>
> (ii) the value, as of the effective date of the plan, of property to be distributed under the plan on account of such claim is not less than the allowed amount of such claim; or
>
> (C) the debtor surrenders the property securing such claim to such holder. . . .

11 U.S.C. § 1325(a)(5). Thus, a debtor seeking confirmation of his plan has three options with respect to each allowed secured claim included in the plan. If the creditor holding the allowed secured claim accepts the plan, nothing more is required. Alternatively, the debtor may invoke the so-called "cram down" power of subsection (B) to confirm the plan over the creditor's objection. Under this option, the creditor retains his lien and the debtor agrees to distribute to the creditor, over the life of the plan, property whose present value is not less than the amount of the creditor's allowed secured claim. Finally, the debtor may surrender the property securing the claim—i.e., the collateral—to the creditor.

If the creditor does not accept the plan and the debtor does not want to surrender the collateral, then the debtor must invoke the cram down power. Because this option requires a distribution to the creditor of property whose present value is no less than the amount of the creditor's allowed secured claim, it is necessary to determine the amount of the allowed secured claim before confirming the plan. Section 506(a) of the Bankruptcy Code, 11 U.S.C. § 506(a), prescribes the method for making this determination. That section states in relevant part:

> An allowed claim of a creditor secured by a lien on property in which the estate has an interest . . .

is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property . . . and is an unsecured claim to the extent that the value of such creditor's interest . . . is less than the amount of such allowed claim. Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor's interest.

11 U.S.C. § 506(a). Thus, the amount of the allowed secured claim is equal to "the value of such creditor's interest in the estate's interest in such property."

B. ACC's Arguments

According to ACC, § 506(a) mandates that the value of the creditor's interest in the estate's interest in the collateral for cram down purposes is equal to its so-called "replacement cost," or in this case, the amount that the Rashes would have to pay to purchase an identical truck of the same vintage and condition from a retail truck dealer.[3] ACC advances several arguments in support of this position. Its principal contention is that this interpretation of § 506(a) is truer to the plain language of the statute and the economic realities of the parties' situation than the reading offered by the bankruptcy court. ACC also argues that the legislative history of § 506(a) reinforces this interpretation. Finally, ACC suggests that we should adopt its interpretation of § 506(a) to avoid a circuit split. We address each of these arguments in turn.

[3] ACC does not contend that "replacement cost" means the cost to the Rashes of purchasing a *new* truck of the same make and model; rather, the phrase means the cost to the Rashes of purchasing a hypothetical truck that is identical in all respects—age, mileage, and operating condition—to the Rashes' truck.

C. Textual and Structural Analysis

1. The Significance of State Law in Analyzing the Text of the Bankruptcy Code

Before we address ACC's plain language argument, we note that if § 506(a) requires a replacement cost valuation, it changes the extent to which ACC is secured from what obtained under state law prior to the bankruptcy filing. Texas law offers a secured party two remedies against a debtor in default: (1) it may dispose of the collateral in a "commercially reasonable" manner and apply the proceeds to satisfaction of the debt, TEX. BUS. & COM. CODE ANN. § 504(a), (c); or (2) it may retain the collateral in total satisfaction of the debt. TEX. BUS. & COM. CODE ANN. § 9.505. *Tanenbaum v. Economics Lab., Inc.*, 628 S.W.2d 769, 771-72 (Tex. 1982). Should the creditor elect the first remedy under § 9.504(a) and that the proceeds are less than the amount of the debt, it has an unsecured claim under § 9.504(b) for the balance and may sue for the deficiency. *Id.* at 771. Accordingly, before the Rashes filed for bankruptcy, ACC was secured under § 9.504(a) and § 9.505 to the extent of what it could realize by resort to these two remedies, and, if it elected to proceed under § 9.504(a), it was unsecured under § 9.505(b) for the balance of its claim. Under ACC's reading of § 506(a), it is now secured to the extent of what it would cost the Rashes to replace the truck. To be sure, the Bankruptcy Code modifies ACC's *collection rights* as a secured creditor under state law——unless lifted, the automatic stay precludes any recourse to state law remedies in a Chapter 13 case until the debtor is discharged, which usually occurs when the debtor has completed all payments under the plan. 11 U.S.C. §§ 362(a), (c)(2); 1328(a). The question remains, however, whether the Code also modifies the extent to which the Rashes' debt to ACC is secured. Generally, such a departure from state law requires "clear[] textual guidance."

BFP v. Resolution Trust Corp., 114 S. Ct. 1757, 1764 (1994) (declining to read § 548 of the Bankruptcy Code as requiring a foreclosure sale to yield a minimum price beyond what state foreclosure law requires "absent clearer textual guidance than the phrase 'reasonably equivalent value' "); *see also Midlantic Nat'l Bank v. New Jersey Dep't of Envtl. Protection*, 474 U.S. 494, 501 (1986) (noting that congressional intent to create an exemption from nonbankruptcy law must be "clearly expressed"); *Butner v. United States*, 440 U.S. 48, 55 (1979) (recognizing that property interests, including security interests, are created and defined by state law, and should not be analyzed differently in a bankruptcy proceeding unless mandated by "congressional command" or an "identifiable federal interest"). *Butner* and its progeny simply reflect the cautious regard for state law that federal courts ordinarily exhibit (and should exhibit) in cases where state and federal law intersect. These cases necessarily will inform our analysis of ACC's plain language argument: not only must ACC's reading of § 506(a) comport with the statutory language, but the statutory language must clearly compel any departure from state law produced by that reading.[4]

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[4] The dissent makes the surprising statement that "there is no state law regarding the rights of secured creditors in reorganizations," thereby apparently obviating the need to look for a clear expression of congressional intent to modify what secured (and presumably unsecured) creditors involved in a reorganization are entitled to receive in payment of their claims. *See Associates Commercial Corp. v. Rash (In re Rash)*, —— F.3d ——, ——, —— *4, 20 (5th Cir. 1996) (en banc) (Smith, J., dissenting). In so doing, the dissent overlooks two important facts. First, there is no state bankruptcy law generally. State law is concerned with the manner in which individual creditors collect their respective claims; bankruptcy law provides for the collective treatment of the claims of multiple creditors when a debtor faces financial collapse. *See generally* Elizabeth Warren, *Bankruptcy Policy*, 54 U. CHI L. REV. 775 (1987); Douglas G. Baird, *Loss Distribution, Forum Shopping, and Bankruptcy: A Reply to Warren*, 54 U. CHI. L. REV. 815 (1987). Second, the primary function of bankruptcy law is to pay creditors (although there are other objectives served by bankruptcy law as well), and the reorganization alternative is simply one method of facilitating those payments. To confine the rule of *BFP*, *Midlantic*, and *Butner* to non-reorganization cases would eliminate the discipline and protection of that rule for creditors in a large number of bankruptcy cases. It would be particularly startling to do so when the issue is what secured creditors and unsecured creditors are to be paid in respect of their state law claims.

2. Section 506(a): The First Sentence

Our analysis begins with the first sentence of § 506(a). It states that an allowed claim is a secured claim to the extent of "the value of such creditor's interest in the estate's interest in such property." ACC argues that this sentence only describes *what* a court has to value—the collateral—because the *Supreme Court* has read the quoted language to mean "the value of the collateral." *United Sav. Ass'n v. Timbers of Inwood Forest Assocs., Ltd.*, 484 U.S. 365, 372 (1988). Therefore, ACC asserts, the first sentence says nothing about *how* a court is to value the collateral.

We do not accept ACC's invitation to give uncritical treatment to the words "the value of such creditor's interest in the estate's interest in such property" simply because they have been judicially distilled to the phrase "the value of the collateral." Although we do not disagree with this interpretation, we are not free to ignore the precise words of the statute. If Congress intended the first sentence of § 506(a) to indicate only that a claim was secured to the extent of the value of the collateral, it could have drafted it with more economy. Therefore, we look to see what additional meaning the first sentence harbors.

The first sentence clearly envisions a layered analysis. The bankruptcy court must first ascertain the estate's interest in the property securing the creditor's lien.[5] The

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[5] Of course, if there were some dispute as to exactly what property secured the creditor's lien, that would necessarily be-

court must then determine the creditor's interest in the estate's interest found in the first step. Finally, the court values the creditor's interest found in the second step to arrive at the amount of the creditor's allowed secured claim.

Beginning with the first step, we note that the focus is on the interest of the "estate" in the property, rather than that of the "debtor." The reason for this designation is that the commencement of a bankruptcy case creates an estate and, with some exceptions, the debtor's legal and equitable interests in property at that time become interests of the estate. 11 U.S.C. § 541. The distinction is also necessary because the debtor may in some instances retain all or a portion of a property interest by exempting it from the property of the estate. 11 U.S.C. § 522; *see, e.g., First of America Bank v. Gaylor (In re Gaylor)*, 123 B.R. 236, 240 (Bankr. E.D. Mich. 1991) (debtor may retain interest in property to the extent of his equity in the property or the statutory exemption ceiling, whichever is less; estate has interest in remainder).

The estate's "interest" in the property is a broad concept that incorporates multiple attributes. *See* BLACK'S LAW DICTIONARY 812 (6th ed. 1990) (defining "interest" as "[t]he most general term than can be employed to denote a right, claim, title, or legal share in something"). One attribute is the estate's *share* in the property vis à vis others. For example, the debtor may have been the sole owner of the property or he may have been a co-owner. Another attribute is the nature of the property interest held by the estate. In this regard, the debtor's interest may have been in fee or merely possessory, present

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come the first inquiry. For example, in the case *sub judice*, there was some dispute as to whether ACC's security interest extended to the lease payments Rash received from leasing his truck to a freight carrier. The bankruptcy court determined that it did not, and that issue is not before us on appeal.

or future, vested or contingent. Consequently, the court's ultimate valuation decision must account for the fact that the estate's interest in the property may be something less than sole fee ownership. 3 COLLIER ON BANKRUPTCY ¶ 506.04, at 506-17 (Lawrence P. King et al. eds., 15th ed. 1996) [hereinafter COLLIER].

Having ascertained the estate's interest in the property, the bankruptcy court must then determine the creditor's interest in the estate's interest. The use of the parallel phrases "estate's interest" and "creditor's interest" is insructive—as with the estate's interest, the court must consider the various attributes comprising the creditor's "interest." Again, the creditor's share in the estate's interest is significant. The creditor's lien may only be a partial lien or it may be junior to other liens also secured by the estate's interest in the property. Likewise, the *nature* of the creditor's interest is another important attribute. Whereas the nature of the estate's interest contemplates several variables, the nature of the creditor's interest is by definition a security interest. Although its precise contours are fixed by agreement between the creditor and the debtor and state law, a security interest may generally be defined as "[a] form of interest in property which provides that the property may be sold on default in order to satisfy the obligation for which the security interest is given." BLACK'S LAW DICTIONARY 1357 (6th ed. 1990). As with the estate's interest, the court's ultimate valuation must take into account the various attributes of the creditor's interest.

Finally, the first sentence directs that the bankruptcy court value the creditor's interest in the estate's interest in the property. The foregoing analysis of these interests suggests a logical starting point for the valuation: what the creditor could realize if it sold the estate's interest in the property according to the security agreement, taking into account the rights of other creditors with liens secured by the estate's interest. Focusing on the creditor's

potential recovery makes sense because the first sentence of § 506(a) refers to "the value of such creditor's interest." The words " *in* the estate's interest in the property" only designate the object in which the creditor has an interest. To be sure, these words do limit the value of the creditor's interest—the creditor's interest *in* something cannot be greater than the thing itself—but they do not call for a separate valuation of the estate's interest.[6] Otherwise, the first sentence would read "the value of such creditor's interest in the *value of* the estate's interest in such property." Ultimately, it is the creditor's interest that is being valued under § 506(a), and such valuation must account for the fact that the creditor's interest is in the nature of a security interest, giving the creditor the right to repossess and sell the collateral and nothing more. Therefore, the valuation should start with what the creditor could realize by exercising that right. *See, e.g., General Motors Acceptance Corp. v. Mitchell (In re Mitchell)*, 954 F.2d 557, 560 (9th Cir.), *cert. denied*, 506 U.S. 908 (1992); *Valley Nat'l Bank v. Malody (In re Malody)*, 102 B.R. 745, 750 (Bankr. 9th Cir. 1989); *Overholt v. Farm Credit Servs. (In re Overholt)*, 125 B.R. 202, 215 (S.D. Ohio 1990); *Grubbs v. National Bank*, 114 B.R. 450, 452-53 (D.S.C. 1990); *Memphis Bank & Trust Co. v. Walker*, 14 B.R. 264, 265 (W.D. Tenn. 1981); *In re Byington*, No. 96-10370, 1996 WL 341933, at *7 (Bankr. D. Kan. June 20, 1996); *In re 203 North LaSalle St. Ltd. Partnership*, 190 B.R. 567, 578 (Bankr. N.D. Ill. 1995), *aff'd*, 195 B.R. 692 (N.D. Ill. 1996); *In re Penick*, 170 B.R. 914, 918-19 (Bankr. W.D. Mich. 1994); *Ford Motor Credit Co. v. Phillips (In re Phillips)*, 142 B.R. 15, 17 (Bankr. D.N.H. 1992); *In re Owens*, 120 B.R. 487, 490 (Bankr. E.D. Ark. 1990);

[6] We recognize that a valuation may begin by valuing the estate's interest in the collateral as a reference point for determining the value of the creditor's interest. Thibodeaux used that beginning point here. We note only that § 506(a) does not, in haec verba, call for a valuation of the estate's interest in the collateral.

Johnson v. General Motors Acceptance Corp., 115 B.R. 515, 516 (Bankr. D.S.C. 1988); *In re Claeys*, 81 B.R. 985, 992 (Bankr. D.N.D. 1987); *In re Cook*, 38 B.R. 870, 875 (Bankr. D. Utah 1984); *In re Klein*, 10 B.R. 657, 660 (Bankr. E.D.N.Y. 1981); *Chrysler Credit Corp. v. Van Nort (In re Van Nort)*, 9 B.R. 218, 221 (Bankr. E.D. Mich. 1981); *In re Adams*, 2 B.R. 313, 313 (Bankr. M.D. Fla. 1980).

Our analysis does not conflict with the Supreme Court's reading of the phrase "the value of such creditor's interest in the estate's interest in such property" to mean "the value of the collateral." Indeed, we also interpret the quoted statutory language to mean "the value of the collateral," but more precisely, "the value of the collateral *to the creditor*." *See In re Raylin Dev. Co.*, 110 B.R. 259, 261 (Bankr. W.D. Tex. 1989) ("[V]aluation must be approached in large part from the point of view of what the collateral would be worth *in the hands of the creditor* under the circumstances of the case."); *In re Boring*, 91 B.R. 791, 795 (Bankr. S.D. Ohio 1988) ("[I]t is the creditor's interest in property which should be valuded under § 506, not the value, *per se*, of the property itself."); *see also* James F. Queenan, Jr., *Standards for Valuation of Security Interests in Chapter 11*, 92 Com. L.J. 18, 30 (1987). Given this analysis, it is clear that the plain language of the first sentence of § 506(a) does not require a replacement cost valuation, as urged by ACC. Moreover, this language does not compel the departure from state law that a replacement cost valuation would produce. To the contrary, the first sentence calls for a valuation that preserves the extent to which a creditor is secured under state law by establishing that a creditor's claim is a secured claim to the extent of the value of its security interest.

3. Section 506(a): The Second Sentence

We now look to the second sentence of § 506(a) to see if it qualifies the first sentence so as to mandate the re-

placement cost valuation proposed by ACC. Again, the second sentence states that:

> Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor's interest.

11 U.S.C. § 506(a). "Such value" naturally refers to "the value of such creditor's interest in the estate's interest in such property," which we read to mean the value of the collateral to the creditor. The second sentence directs that the bankruptcy court determine this value "in light of" two factors: "the purpose of the valuation" and "the proposed disposition or use of such property." We consider each of these factors in turn.[7]

a. "The Purpose of the Valuation"

The meaning of "the purpose of the valuation" is not obvious from the words themselves or from the remaining text of § 506(a). Of course, that subsection does indicate that the purpose of valuing the collateral is to determine the amout of the secured and unsecured portions of the creditor's allowed claim, but that is true in every case. The meaning of these words becomes clear, however, when one considers that several different provisions of the Bankruptcy Code call for calculations of the extent to which an allowed claim is secured. For example, such a calculation is necessary to determine a debtor's eligibility for Chapter 13 protection under § 109(e),[8] to

[7] The last part of § 506(a) requires that, if there is a hearing on the proposed disposition or use of the property or on a plan affecting the creditor's interest, the court must determine the value of the creditor's interest in the estate's interest in the property in conjunction with that hearing. This requirement is not at issue in this appeal.

[8] 11 U.S.C. § 109(e) provides:

> Only an individual with regular income that owes, on the date of the filing of the petition, noncontingent, liquidated,

assess adequate protection for a creditor requesting stay relief under § 362(d)[9] or being subjected to a senior or equal lien under § 364(d),[10] to establish what the debtor must pay the creditor to redeem property under § 722,[11] or to ascertain the amount to be distributed to the holder of a secured claim in a reorganization plan under Chap-

> unsecured debts of less than $250,000 and noncontingent, liquidated, secured debts of less than $750,000, or an individual with regular income and such individual's spouse, except a stockbroker or a commodity broker, that owe, on the date of the filing of the petition, noncontingent, liquidated, unsecured debts that aggregate less than $250,000 and noncontingent, liquidated, secured debts of less than $750,000 may be a debtor under chapter 13 of this title.

[9] 11 U.S.C. § 362(d) provides in pertinent part:

> On request of a party in interest and after notice and a hearing, the court shall grant relief from the stay . . ., such as by terminating, annulling, modifying, or conditioning such stay—
>
> (1) for cause, including the lack of adequate protection of an interest in property of such party in interest . . . .

[10] 11 U.S.C. § 364(d) provides in pertinent part:

> (1) The court, after notice and a hearing, may authorize the obtaining of credit or the incurring of debt secured by a senior or equal lien on property of the estate that is subject to a lien only if—
>
> . . . .
>
> (B) there is adequate protection of the interest of the holder of the lien on the property of the estate on which such senior or equal lien is proposed to be granted.

[11] 11 U.S.C. § 722 provides:

> An individual debtor may, whether or not the debtor has waived the right to redeem under this section, redeem tangible personal property intended primarily for personal, family, or household use, from a lien securing a dischargeable consumer debt, if such property is exempted under section 522 of this title or has been abandoned under section 554 of this title, by paying the holder of such lien the amount of the allowed secured claim of such holder that is secured by such lien.

ter 11, 12, or 13.[12] Thus, there are many "purposes" for which the bankruptcy court may need to conduct a valuation under § 506(a). The directive to consider the particular purpose at hand indicates that a valuation for one purpose will not necessarily control for another. *Resolution Trust Corp. v. Murray [In re Midway Partners]*, 995 F.2d 490, 494 (4th Cir.), *cert. denied,* 114 S. Ct. 599 (1993); *Fairchild v. Lebanon Prod. Credit Ass'n (In re Fairchild),* 31 B.R. 789, 795 (Bankr. S.D. Ohio 1983); *see also* Queenan, *supra,* at 38 ("[I]t seems likely that the reference in Section 506(a) to purpose and disposition or use was intended merely to make it clear that a valuation in one setting would not be binding upon a valuation in another.").[13] One reason that a prior valuation should not be binding is that the value of the collateral may change during the bankruptcy cases, thereby requiring new valuations at each proceeding. *See In re Midway Partners,* 995 F.2d at 494; *Schreiber v. United States (In re Schreiber),* 163 B.R. 327, 332 (Bankr. N.D. Ill. 1994); *see also* 3 COLLIER ¶ 506.04, at 506-25. Another reason could be that each section calling for a valuation presents "unique considerations" that the court may find to affect value. *See In re Hoskins,* 183 B.R. 166, 169 (Bankr. S.D. Ind. 1995); *see also United States v. Arnold*

[12] Each chapter provides that, in lieu of surrendering the collateral to the creditor, the debtor may provide in his plan for a distribution to the creditor, the present value of which is at least equal to the amount of the allowed secured claim. 11 U.S.C. §§ 1129(b)(2)(A)(i), 1225(a)(5)(B), 1325(a)(5)(B).

[13] The legislative history of § 506(a) supports this proposition:

> While courts will have to determine value on a case-by-case basis, the subsection makes it clear that valuation is to be determined in light of the purpose of the valuation . . . . To illustrate, a valuation early in the case in a proceeding under sections 361-363 would not be binding upon the debtor or creditor at the time of confirmation of the plan.

S. Rep. No. 989, 95th Cong., 2d Sess. 68 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5854.

and Baker Farms (In re Arnold and Baker Farms), 177 B.R. 648, 656 (Bankr. 9th Cir. 1994) ("[A] bankruptcy court may approach a valuation in the context of a relief from the stay hearing under § 362 differently than it would in the context of a 'cram down' under § 1129(b)."), *aff'd,* 85 F.2d 1415 (9th Cir. 1996).

The purpose of the valuation in this case is to determine the amount of the distribution that ACC must receive under the Rashes' plan in order to meet 1325(a)(5)'s confirmation requirement under the cram down option. There has been no prior valuation for another purpose. We still look to § 1325(a)(5), however, to see whether it interjects any unique considerations that would inform a § 506(a) valuation. *In re Hoskins,* 183 B.R. at 170 (noting that the § 506 rights of a creditor subject to Chapter 13 cram down "cannot be ascertained without reference to § 1325"); *cf. Nobelman v. American Sav. Bank,* 508 U.S. 324 (1993) (holding that valuation of a residence under § 506(a) must account for "interplay" between that subsection and § 1322(b)(2), which protects the rights of the holder of a security interest in the debtor's principal residence).

As previously noted, a Chapter 13 debtor has two options if the holder of a secured claim does not accept the plan: (1) he may provide in the plan for a distribution to the creditor, the present value of which is at least equal to the amount of the secured claim; or (2) he may surrender the property securing the claim to the creditor. 11 U.S.C. § 1325(a)(5)(B), (C). Structurally, it appears that these two alternatives are set forth as equivalent methods of protecting the creditor's security interest where it does not accept the debtor's treatment of that interest under the plan. Accordingly, one would expect that these alternatives would yield the same result. If the debtor chose to surrender the collateral to the creditor, the creditor would be protected to the extent of what it could realize by disposing of the collateral in a commer-

cially reasonable disposition. Likewise, if the debtor chose to retain the collateral and pay the creditor the amount of its secured claim, the creditor would receive the same protection if the amount to be paid were equal to what the creditor could realize by repossession and sale. As two commentators put it:

> Section 1325(a)(5)(B) is meant to ensure that a secured creditor will receive the equivalent of recourse to the collateral which was the inducement for extending the loan to the debtor. In other words, section 1325(a)(5)(B) protects the creditor's expectations of recovery against the debtor in the event of default. As long as only the debtor and creditor are involved, these expectations are protected by guaranteeing the creditor the amount he would receive upon repossession and sale of the collateral.

S. Andrew Bowman & William M. Thompson, *Secured Claims Under Section 1325(a)(5)(B): Collateral Valuation, Present Value, and Adequate Protection*, 15 IND. L. REV. 569, 577 (1982), *quoted with approval in Grubbs v. National Bank*, 114 B.R. 450, 452 (D.S.C. 1990), *and In re Cook*, 38 B.R. 870, 876 (Bankr. D. Utah 1984); *see also General Motors Acceptance Corp. v. Jones*, 999 F.2d 63, 66-67 (3rd Cir. 1993) ("§ 1325(a)(5)(B)(ii) . . . seeks to put the secured creditor in an economic position equivalent to the one it would have occupied had it received the allowed secured amount immediately, thus terminating the relationship between the creditor and the debtor.").

A replacement cost valuation under § 506(a) contravenes the apparent symmetry of the protection offered by § 1325(a)(5)(B) and (C). Valuing the creditor's secured claim at the replacement cost to the debtor will generally give the creditor more protection under subsection (B) than it would have under subsection (C); that is, the amount that the debtor would have to pay to replace the collateral will generally be greater than the amount that

the creditor could realize if the debtor surrendered the collateral and the creditor sold it. Nothing in the language or structure of § 1325(a)(5) seems to compel this additional protection under subsection (B). If anything, the structure of § 1325(a)(5) would seem to call for a valuation tied to the creditor's potential recovery upon a commercially reasonable sale of the collateral. 5 COLLIER ¶ 1325.06, at 1325-54 n.130 ("Since the purpose of the valuation [under § 1325(a)(5)(B)] is to protect the value that the secured creditor would receive if it repossessed the collateral and disposed of it, in which case the creditor would have to incur the costs of resale, it is appropriate to use the wholesale value of the property for this purpose, rather than the retail resale value.").

b. "The Proposed Disposition or Use of Such Property"

The second sentence of § 506(a) also commands that the valuation be made "in light of . . . the proposed disposition or use" of the collateral. ACC reads this language to compel a replacement cost valuation via the following logic: (1) because the "proposed disposition or use" is use by the debtor rather than disposition by the debtor or creditor, the value of the property is its worth to the debtor; and (2) the worth of the property to the debtor while he is using it is what it would cost the debtor to replace the property. ACC argues that the bankruptcy court defied this statutory mandate by ignoring the *proposed* use of the truck by the Rashes and by instead valuing the truck according to what ACC would realize in a *hypothetical* disposition of the truck. In so doing, ACC contends, the court failed to give effect to the "proposed disposition or use" language and thereby contravened the canon of statutory construction that "a statute must, if possible, be construed in such fashion that every word has some operative effect." *United States v. Nordic Village, Inc.*, 503 U.S. 30, 36 (1992). By contrast, ACC

points out that its reading of § 506(a) gives effect to the second sentence in that subsection.

We cannot conclude that § 506(a)'s directive that valuations be made "in light of . . . the proposed disposition or use of such property" offers the "clear textual guidance" needed to justify the departure from state law effected by a replacement cost valuation. Contrary to ACC's assertion, this language does not patently lead to the conclusion that, where the debtor proposes to retain and use the collateral, the value of the collateral is equal to what it would cost the debtor to replace it. ACC must bridge the gap between the statutory language and this conclusion with its own peculiar line of logic.

Moreover, this logic is corrupted by an obvious non sequitur. It simply does not follow that, because the collateral is being retained and used by the debtor, its vaule is necessarily measured by its worth to the debtor. When the collateral is in the hands of the debtor in a Chapter 13 cram down, it is worth something to both the debtor and the creditor. The collateral has worth to the debtor because he has an ownership or a possessory interest; the collateral also has worth to the creditor because it has a security interest. Thus, if the "proposed disposition or use" language in § 506(a) merely tells us to value the collateral in light of the fact that the debtor has retained possession, that says nothing about whether its worth to the debtor or its worth to the creditor is the appropriate measure of its value.

Similarly misguided is ACC's claim that its explication of § 506(a) is superior to that of the bankruptcy court because it focuses on the actual proposed use of the collateral by the debtor rather than a hypothetical disposition by the creditor. "[T]he entire process of claim valuation is 'purely hypothetical,' since it ascribes value to property without an actual sale." *In re 203 North LaSalle St. Ltd. Partnership,* 190 B.R. 567, 579 n.2 (Bankr. N.D. Ill. 1995), *aff'd,* 195 B.R. 692 (N.D. Ill. 1996). Indeed, by

ACC's own reasoning, the collateral's worth to the debtor is measured by reference to a hyopthetical transaction—what it would cost the debtor to purchase a replacement for the collateral. Likewise, the worth to the creditor is what the creditor could realize if it repossessed and sold the collateral according to the security agreement. Therefore, ACC's interpretation of § 506(a) is equally susceptible to the "criticism" that it hypothesizes a transaction to determine value.[14]

We note further that the collateral's replacement cost represents the value of the *estate*'s interest in the collateral. Thus, a replacement cost valuation, which measures an

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[14] In the same vein, ACC argues that the bankruptcy court erred in deducting the hypothetical costs of foreclosure and disposition from the value that ACC would realize upon repossession and sale. Although there is language in a footnote to the bankruptcy court's opinion that suggests that the court would ordinarily deduct such costs in determining wholesale price, 149 B.R. at 434 n.3, it did not do so here because neither party presented any evidence on this point. Rather, the court determined as a matter of fact that the proceeds of a foreclosure sale of the truck by ACC would be the wholesale price of the truck—$31,875; the court then held that this amount was the value of the truck to ACC. *Id.* at 434.

Some courts have questioned the propriety of deducting foreclosure and disposition costs from the proceeds that a creditor would receive upon foreclosure:

> When a creditor forecloses on the property . . ., the creditor "receives" *all* of the proceeds of the sale. This amount is applied to the debtor's obligation which, by that time, includes the outstanding principal and accrued interest *plus,* almost-universally as a matter of contract, the creditor's costs, fees and expenses connected with the foreclosure. There is no basis, however, for assuming that the costs of sale are paid with the "first dollar" of the sale proceeds rather than being added to the debtor's deficiency.

Huntington Nat'l Bank v. Pees (In re McClurkin), 31 F.3d 401, 404-05 (6th Cir. 1994). In this case, however, we have no occasion to address the propriety of deducting foreclosure and disposition costs from the proceeds of a hypothetical foreclosure sale because no such deduction took place.

ownership or possessory interest, directly conflicts with the first sentence's instruction to value the *creditor's* interest in the estate's interest in the property, which is a security interest. We would expect Congress to use more explicit language in the second sentence than "in light of . . . the proposed disposition or use of such property" to carve out such an antithetical exception to the first sentence. Indeed, it would be strange to cast a replacement cost requirement as an exception. A rule mandating a replacement cost valuation whenever the debtor proposes to retain the collateral would embrace many of the possible scenarios under which a valuation takes place. Again, we would expect Congress to establish such a far-reaching rule with more explicit language. Accordingly, we do not believe that § 506(a)'s reference to the proposed disposition or use of the collateral clearly demands a replacement cost valuation when the debtor retains and uses the collateral.

We also do not agree that requiring a replacement cost valuation when the debtor retains the collateral is necessary to give effect to the second sentence of § 506(a). Apparently, ACC reads the words "[s]uch value shall be determined in light of . . . the proposed disposition or use of such property" to mean that such disposition or use will be *determinative* of value in every case. The use of the word "shall" certainly indicates that the bankruptcy court will have to look at the proposed disposition or use of the collateral in making its valuation. The phrase "in light of," however, suggests that the court need only consider the proposed disposition or use, *see* THE AMERICAN HERITAGE DICTIONARY 729 (2d Coll. ed. 1982) (defining the idiom "in (the) light of" as "[i]n consideration of"); it does not dictate that such disposition or use will necessarily affect the result.[15] We would expect Con-

[15] Of course, the same analysis applies to the purpose of the valuation, the other factor enumerated in § 506(a)'s second sentence.

gress to use more forceful language if the proposed disposition or use of the collateral were to have a positive or negative effect on value in every case. Indeed, given the myriad purposes for which a court must conduct valuations under § 506(a), it is not surprising that the collateral's disposition or use would have a determinative impact for some purposes and not for others.

This interpretation finds support in the fact that the words "[s]uch value" in the second sentence refer to "the value of such creditor's interest in the estate's interest in such property" in the first sentence. Accordingly, only those dispositions or uses of the collateral that affect the creditor's security interest should be determinative of value. As Judge Queenan commented:

> The debtor's use of the collateral may be of assistance in delineating the market for the collateral by indicating a use which may be of interest to potential buyers at a foreclosure sale. The statute could also refer to a use which affects value rather than the standard of value. The debtor's use of the collateral may be particularly beneficial, or particularly detrimental, to its value. For example, the collateral may consist of equipment which is being used by the debtor twenty-four hours per day, so that its use is causing rapid deterioration.

Queenan, *supra*, at 37. Similarly, one bankruptcy court explained:

> The emphasis to be placed upon the concept of "use" or "disposition" of property should not be placed in the context of collateral retention by a debtor via a reorganization plan, but rather ought to focus on a use or disposition of collateral that is either destructive or unanticipated in the sense that it would increase the risk of loss to the creditor's interest in the collateral. Illustrative of such use in a Chapter 12

> treatment context might be a post-confirmation proposal to use a combine for custom work where previously it had been used seasonally to harvest the debtor's own crop. Thus, the second sentence of section 506(a) should not have any effect upon how the value of a creditor's interest in collateral is arrived at, at least in the context of collateral retention unless the manner of that retention is so unusual or extreme as to constitute a use that is destructive of the collateral itself in a way unanticipated.

In re Claeys, 81 B.R. 985, 992 (Bankr. D.N.D. 1987).

Perhaps the most common example of a situation in which disposition or use will be determinative is when a creditor moves for relief from the automatic stay under § 362(d)(1) on the ground that its interest in the collateral is not being adequately protected. Such a motion calls for the bankruptcy court to compare the value of the creditor's interest at the commencement of the case with its likely value at the date the stay terminates [16] in order to determine whether that value is declining, thereby entitling the creditor to adequate protection in the manner provided by § 361 of the Bankruptcy Code. In this context, the debtor's proposed disposition or use of the collateral will frequently have a determinative effect on the value of the collateral at the later date and, consequently, on the outcome of the motion. The Supreme Court recognized the impact of declining collateral value during the pendency of the stay in its opinion in *Timbers*:

> It is common ground that the "interest in property" referred to by § 362(d)(1) includes the right of a secured creditor to have the security applied in

[16] Although the automatic stay may continue in a Chapter 13 case after confirmation of the plan, adequate protection is generally considered to be available only until confirmation. *See* 1 KEITH M. LUNDIN, CHAPTER 13 BANKRUPTCY § 3.39, at 3-23 & n.48 (2d ed. 1994 & Supp. 1995) [hereinafter LUNDIN].

> payment of the debt upon completion of the reorganization; and that that interest is not adequately protected if the security is depreciating during the term of the stay. Thus, it is agreed that if the apartment project in this case had been declining in value petitioner would have been entitled, under § 362(d)(1), to cash payments or additional security in the amount of the decline, as § 361 describes.

Timbers, 484 U.S. at 370. Other courts have also acknowledged the relationship between the proposed disposition or use of the collateral and adequate protection. *See, e.g., Bank Hapoalim B.M. v. E.L.I., Ltd.*, 42 B.R. 376, 379 (N.D. Ill. 1984) (finding that creditor's interest in collateral would be adequately protected where collateral's value, as evidenced by the contract price for a proposed sale of the collateral, exceeded creditor's claim); *In re Mueller*, 123 B.R. 613, 615-16 (Bankr. D. Neb. 1990) (holding that creditor's interest in collateral would not be adequately protected because evidence showed that debtor's heavy use of collateral would affect its value); *In re Wolsky*, 46 B.R. 262, 265 (Bankr. D.N.D. 1984) (requiring adequate protection payments to compensate creditor for $25,000 loss in value occasioned by debtor's future use of collateral); *First Fed. Sav. & Loan Assoc. v. Shriver (In re Shriver)*, 33 B.R. 176, 178 (Bankr. N.D. Ohio 1983) (valuing collateral for purposes of motion for relief from stay by considering use of collateral as home, dairy farm, and feeder cattle farm).[17]

[17] The adequate protection provisions were a new addition to the bankruptcy law when they were included in the Bankruptcy Code in 1978, reflecting a few prior decisions in the case law that sought to protect secured creditors from a decline in the value of the collateral during the pendency of the stay. *See generally United Sav. Ass'n v. Timbers of Inwood Forest Assocs., Ltd. (In re Timbers of Inwood Forest Assocs., Ltd.)*, 793 F.2d 1380, 1389-1401 (5th Cir. 1986) (discussing history of adequate protection provisions), *aff'd on reh'g*, 808 F.2d 363 (5th Cir. 1987), *aff'd*, 484 U.S. 365 (1988). Accordingly, it is probably no accident that

By contrast, where the debtor retains the collateral and uses it for its usual, intended purpose, such retention and use should not ordinarily affect a valuation under § 506 (a) for the purpose of Chapter 13 cram down. In this case, the bankruptcy court found that the Rashes' proposed use of the truck—hauling freight—was its intended purpose and that the truck was insured and maintained. *Id.* at 434. Accordingly, the court concluded that the Rashes' retention and use of the truck did not affect its value to ACC. *Id.* at 433. Based on the evidence presented to the court, this finding is not clearly erroneous.

In sum, we reject ACC's contention that the plain language of § 506(a) calls for a replacement cost valuation where the debtor proposes to retain and use the collateral. Certainly, the language of that subsection does not provide the clear textual guidance necessary to command the departure from state law effected by such a valuation. If anything, § 506(a) reaffirms the extent to which a creditor is secured under state law by suggesting a valuation that starts with what the creditor could realize by repossession and sale of the collateral.[18] This reading

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the "proposed disposition or use" language of § 506(a) was added to the Code at this time to guide courts in making valuation decisions under these important new provisions. This language, however, is most certainly not limited to the context of adequate protection motions.

[18] Similarly, § 506(a) reaffirms the extent to which a creditor was secured under pre-Bankruptcy Code practice. Under English bankruptcy law, an undersecured creditor was required to deduct the value of its security from the total debt and was then entitled to receive a ratable dividend from the debtor's assets with respect to the remainder. *See Merrill v. National Bank of Jacksonville*, 173 U.S. 131, 153 (1899) (White, J., dissenting). To determine the value of the security, the creditor was required to sell it, because "[[illegible]] his debt has been reduced by the proceeds of that sale, it is [illegible]ible correctly to say what the actual amount of it is." *Id* [illegible] 154 (quoting *Ex Parte Smith*, 2 Rose 63 (1813) (internal quotation marks omitted)). The court apparently had discretion to relax this rule in appropriate cases. *Id.* In this

gives full effect to § 506(a)'s second sentence by directing the court to consider in every case two factors that may affect the value of the creditor's security interest—the purpose of the valuation and the proposed disposition or use of the collateral.

D. Economic Analysis

1. Effect of the Debtor's Retaining the Collateral on the Value of the Creditor's Interest

ACC also argues that a replacement cost valuation more accurately reflects the economic relationship be-

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country, prior to the enactment of the Bankruptcy Code, "the status of secured claims and the valuation of the security held therefor were governed by Section 57h [of the Bankruptcy Act of 1898] and Bankruptcy Rule 306(d)." 3 COLLIER ¶ 506.02, at 506-3. As under English law, § 57h provided that a creditor was required to deduct the value of its security from its claim before receiving a dividend on the unsecured portion. 11 U.S.C. § 93(h). Such value was determined

> by converting the same into money according to the terms of the agreement pursuant to which such securities were delivered to such creditors, or by such creditors and the trustee by agreement, arbitration, compromise or litigation, as the court may direct . . .

Id. Thus, § 57(h) preserved the English method of valuing the secured portion of a creditor's claim by having the creditor realize upon the security according to the terms of the security agreement. Alternatively, such value would be determined by "agreement, arbitration, compromise or litigation." *Id.* There was no provision, however, for valuing a secured claim by reference to the collateral's replacement cost to the debtor.

Therefore, by suggesting a valuation that starts with what the creditor could realize by foreclosing on the collateral, § 506(a) mirrors valuation methods under prior bankruptcy law. Moreover, valuing the secured portion of a creditor's claim at the collateral replacement cost would effect a departure from pre-Code practice. As with state law, clear textual guidance is necessary to justify a departure from prior bankruptcy law. *See Dewsnup v. Timm*, 502 U.S. 410, 433, 112 S.Ct. 773, 786-87, 116 L.Ed.2d 903 (1992) (Scalia, J., dissenting) (citations omitted). We find such guidance entirely absent here.

tween the creditor and the debtor when the debtor proposes to retain and use the collateral as part of his Chapter 13 plan. First, ACC contends that, by retaining the collateral, the debtor is acknowledging that its value is greater than its liquidation price. See In re Penz, 102 B.A. 826, 828 (Bankr. E.D. Okla. 1989). If the debtor could not retain the collateral, he would have to purchase a replacement. Thus, ACC asserts that replacement cost is the appropriate measure of value. According to ACC's logic, the creditor's secured claim should reflect this higher value because that value would not otherwise exist if the creditor were allowed to exercise its right to repossess the collateral. *See id.* ("[C]reditor's secured claim is entitled to be valued to the extent of its contribution to the entire estate. . . ."); *See also In re Crockett,* 3 B.R. 365, 367 (Bankr. N.D. Ill. 1980) ("The value of [the creditor's] secured claim is enhanced by the continued use of the collateral in effectuating the debtor's performance under the plan, which value must be reflected in distributions under the plan.").[19]

We find two problems with this logic. First, replacement cost does not reflect the value of the collateral alone. When hypothetically purchasing a replacement for the collateral from a retail dealer, the debtor would be buying the replacement property and the services provided by a dealer, such as inventory storage, reconditioning, marketing, and warranties of quality. The replacement cost represents the value of the replacement property *and* the value of these services. The creditor, however, has a security interest only in the property that would be replaced, and not in the hypothetical dealer's services. As Judge Easterbrook explained:

> In the retailing business the difference between the wholesale price and the retail price is the "value added" of the business. It is the amount contributed by storing, inspecting, displaying, hawking, collecting for, delivering, and handling warranty claims on the goods. This difference covers the employees' wages, rent and utilities of the premises, interest on the cost of goods, bad debts, repairs, the value of entrepreneurial talent, and so on. The increment of price is attributable to this investment of time and other resources. *The* [*creditor*] *does not have a security interest in these labors. It has an interest only in* [*the collateral*]. *The value of its interest depends on what the* [*creditor*] *could do, outside of bankruptcy, to realize on its security. . . . What it could do is seize and sell the inventory.*

[19] We note that ACC did not argue below and does not argue here that the bankruptcy court should have calculated the value of the truck by using the income stream that it produces.

Samson v. Alton Banking & Trust Co. (In re Ebbler Furniture and Appliances, Inc.), 804 F.2d 87, 92 (7th Cir. 1986) (Easterbrook, J., concurring) (emphasis added), *quoted with approval in Smith v. Associates Commercial Corp. (In re Clark Pipe and Supply Co., Inc.),* 893 F.2d 693, 698 (5th Cir. 1990). Similarly, two commentators noted:

> We believe that a value that approximates wholesale price should be the relevant measure of [the creditor's] claim for purposes of the Chapter 13 cramdown. . . . [T]he inflated retail price includes value-adding activities by the retailer. Because [the creditor] is not a retailer of automobiles, it is unable to take advantage of these value-adding activities. There should be no reason why a secured creditor . . . should profit from the value-adding activities of others. Because the value of an automobile sold in the market at the wholesale level comes almost directly from the manufacturing activities of the dealer, the wholesale price of the automobile likely comes closest to representing the automobile's true worth.

Robert M. Lawless & Stephen P. Ferris, *Economics and the Rhetoric of Valuation,* 5 J. BANKR. L. & PRAC. 3, 18 (1995). Accordingly, the replacement cost of the collateral to the debtor is not an appropriate measure of the creditor's allowed secured claim because it includes the value of services in which the creditor does not have a security interest.[20]

Second, ACC's replacement cost argument appears to be motivated by a desire to compensate creditors for the fact that cram down allows debtors to retain collateral and prevents creditors from foreclosing according to their security agreements. Any such compensation, however, would amount to a bonus to creditors.[21] To the extent

[20] Some courts have implied that replacement cost would be an appropriate measure of value when the creditor is a retail dealer and could charge a retail price if it repossessed and sold the collateral. *See, e.g., Grubbs v. National Bank,* 114 B.R. 450, 452 (D.S.C. 1990); *In re Adams,* 2 B.R. 313, 313 (Bankr. M.D. Fla. 1980). In this case, ACC is not a dealer. Although ACC's expert testified that ACC had received 92% at three foreclosure sales, the bankruptcy court found that ACC could only realize the wholesale price upon repossession and sale of the Rashes' truck. 149 B.R. at 434. The court apparently chose to credit the testimony of the Rashes' expert that he would pay ACC only the wholesale price for the Rashes' truck. Based on the testimony presented at the valuation hearing, we do not think that the court's finding in this regard is clearly erroneous.

[21] The dissent suggests that such a bonus is due secured creditors as a financial reward:

> [A] successful reorganization produces a surplus (relative to liquidation or foreclosure) by allowing the debtor to retain the collateral. The debtor benefits by keeping his property, of course; his creditors benefit from pocketing any income that he generates thereby and from avoiding the transaction costs of resale.
>
> This financial surplus must be divided between secured and unsecured creditors. It makes perfect sense to award much of the surplus to secured creditors, as it exists only because of their collateral.

Rash, —— F.3d at —— *13-14 (Smith, J., dissenting). In the unending debate between secured and unsecured creditors as to which group is entitled to what share of the pie, this argument is frequently adduced as a reason for giving secured creditors more of whatever is at issue. Whatever the merits of this argument in other contexts, it seems peculiarly inapposite in the ordinary Chapter 13 reorganization, where the income generated is derived principally from the debtor's personal labor after confirmation and much of the collateral retained by the debtor (usually consumer goods) is only tenuously related to the production of income. For example, it would be difficult to calculate the "surplus" generated by the debtor's retention of a recliner that he sat in after returning home from an eight-hour shift at a factory.

Still, even in a case such as this, where the creditor's collateral is an income-generating asset, the income necessary to fund the plan derives in critical part from Rash's personal, post-confirmation labor in operating the tractor truck, in which ACC has a security interest, and trailer, in which First National Bank of Jasper has a security interest. Specifically, Rash earns his income by leasing his truck to a freight-hauling business, but a condition of that lease is that Rash himself operate the truck. ACC does not have a security interest in Rash's labor and would have no right to dispose of that labor if it repossessed and sold the truck. Accordingly, it is perverse to argue that the secured creditor's claim should be inflated by the "financial surplus" created in significant part by the debtor's post-confirmation labor.

that cram down prevents the creditor from foreclosing, the creditor is already protected because it will receive payments whose present value equals the value of its security interest in the estate's interest in the property. 11 U.S.C. §§ 506(a), 1325(a)(5)(B). In this case, ACC will receive payments from the Rashes under the plan equal to the amount of its allowed secured claim, together with interest until the claim is paid at the rate of nine percent per annum. As one court indicated:

> Congress has provided protection for the creditor, in the form of the requirement that the amount to be paid to the creditor over time have a current value of not less than would be received in an immediate liquidation.
>
> . . . Those courts which have sought to provide creditors with substantial additional protection, in the

form of providing valuation of the collateral at retail . . . are in effect engaging in judicial legislation and imposing their view of appropriate bankruptcy policy upon litigants within their jurisdiction.

In re Myers, 178 B.R. 518, 523 (Bankr. W.D. Okla. 1995). Judge Lundin has made a similar observation:

To allow sellers and financiers to recover the retail or replacement cost of personal property in Chapter 13 cases is to twice compensate for the risk of nonpayment. Lienholders in Chapter 13 cases are already guaranteed "present value" at confirmation under § 1325(a)(5)(B)(ii).

2 LUNDIN § 5.48, at 5-134. Further, to the extent that the creditor should be compensated beyond what it could realize upon foreclosure, it can easily provide this protection itself. "Lenders and sellers build the risk of default and the risk of bankruptcy into the interest rates they charge, the prices at which they sell, and the transaction costs that they charge." *Id.* Creditors can also protect themselves by requiring a larger down payment or shortening the term of the loan.[22] ACC offers no compelling economic reason why a creditor subject to a Chapter 13 cram down should receive even more compensation in the form of valuing its secured claim at the replacement cost of the collateral.[23]

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[22] Apparently, creditors frequently do not avail themselves of this protection. As one amicus heralds: "Those who finance cars are typically undersecured. The debt exceeds the car's retail value." Association of Int'l Auto. Mfrs., Inc. Brief at 5. Of course, a creditor that purposefully makes a loan that is undersecured from the outset has some difficulty arguing that the Bankruptcy Code puts it in a position of being fully secured or nearly so.

[23] The dissent also suggests that collateral is worth more in a reorganization than in a liquidation because it possesses "going-concern value" in a reorganization. *Rash*, —— F.3d at —— *3 (Smith, J., dissenting) (quoting *United Sav. Ass'n v. Timbers of Inwood Forest Assocs. (In re Timbers of Inwood Forest Assocs.)*, 808 F.2d 363, 373 (5th Cir. 1987) (en banc), *aff'd*, 484 U.S. 365

Moreover, the Supreme Court has arguably rejected the notion that a creditor should receive additional compensation for its inability to foreclose due to cram down. In *United Sav. Ass'n v. Timbers of Inwood Forest Assocs., Ltd.*, 484 U.S. 365 (1988), the Court addressed whether an undersecured creditor was entitled to compensation

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(1988)). "Going-concern," however, is a concept peculiar to businesses. As one bankruptcy court explained:

[G]oing concern valuation incorporates more than a summation of market values attributable to an entity's various assets. It indicates the market value of an ongoing business as a whole and thereby includes an additional element of value that attaches to property considered in the aggregate, by reason of the property having been assembled for the conduct of the business and the property's fitness for such use.

Bergquist v. Anderson-Greenwood Aviation Corp. (In re Bellanca Aircraft Corp.), 56 B.R. 339, 386 (Bankr. D. Minn. 1985) (citations omitted), *rev'd in part on other grounds*, 850 F.2d 1275 (8th Cir. 1988). Given that the concept of going-concern value is associated with business entities, it is not surprising that ACC never made such a claim to the bankruptcy court or adduced any evidence on that subject. Moreover, assuming it were possible to allocate the going-concern value of the business to the individual assets employed in the business, there is no necessary correlation with the replacement costs of those assets. The two valuation methods are fundamentally different.

Finally, our reference in *Timbers* to the benefits that inure to secured creditors from going-concern valuations must be placed in context. In Chapter 11 cases, a going-concern valuation of the reorganized debtor is a *necessary* step in applying the "fair and equitable" standard to a class of unsecured claims or a class of interests in a cram down under § 1129(b). 11 U.S.C. § 1129(b)(1), (2)(B) & (C); 5 COLLIER ¶ 1129.03[4][f][ii] at 1129-110 to -115. It is not uncommon for a secured creditor to assert that the amount of its secured claim should be augmented by a portion of this going-concern value. Indeed, consensual plans under Chapter 11 sometimes, in effect, allocate some of this value to the secured claims. Whether the secured creditors are entitled to this value as a matter of law or equity is not at issue in this case and we express no opinion on it. In any event, the Chapter 11 requirements mandating the going-concern valuations mentioned in *Timbers* do not have an analog in Chapter 13.

under § 362(d)(1) due to the delay caused by the automatic stay in foreclosing on the collateral. The Court held that such compensation was not due because the "interest in property" entitled to adequate protection under § 362(d)(1) did not include the right to immediate foreclosure. *Id.* at 371. In reaching this conclusion, the Court drew an analogy between the "interest in property" protected by § 362(d)(1) and the "creditor's interest in the estate's interest in such property" mentioned in § 506 (a). With respect to the latter phrase, the Court stated:

> *[T]he creditor's "interest in property" obviously means his security interest without taking account of his right to immediate possession of the collateral on default.* If the latter were included, the "value of such creditor's interest" would increase, and the proportions of the claim that are secured and unsecured would alter, as the stay continues—since the value of the entitlement to use the collateral from the date of bankruptcy would rise with the passage of time. No one suggests this was intended.

Id. at 372 (emphasis added). Accordingly, one would not expect the Court to agree that a valuation under § 506(a) for purposes of cram down should provide the creditor with additional compensation in respect of his inability to foreclose. *See General Motors Acceptance Corp. v. Mitchell (In re Mitchell),* 954 F.2d 557, 560-61 (9th Cir., *cert. denied,* 506 U.S. 908 (1992).

2. The Potential for a Windfall

ACC further contends that a foreclosure price valuation where the debtor retains the collateral gives the debtor an opportunity to reap a windfall. Specifically, ACC fears that a debtor could use the cram down provision to bifurcate an undersecured creditor's claim into an unsecured portion and a secured portion valued at the collateral's wholesale price, and later resell the collateral

for a higher price, pocketing the difference. *See Winthrop Old Farm Nurseries v. New Bedford Inst. for Sav. (In re Winthrop Old Farm Nurseries),* 50 F.3d 72, 76 (1st Cir. 1995).

The short answer to this concern is that there is no evidence on this record that the Rashes could sell their truck for a higher price than ACC could obtain at a commercially reasonable sale. *Cf. In re 203 North LaSalle St. Ltd. Partnership,* 190 B.R. 567, 579 n.2 (Bankr. N.D. Ill. 1995) ("A debtor, no less than its secured creditor, would incur disposition costs to obtain this value, and so there is no 'quick profit' available to the debtor."), *aff'd,* 195 B.R. 692 (N.D. Ill. 1996). Indeed, it stretches credulity to suggest that ACC, with all of the financial resources, personnel, and foreclosure sales experience at its disposal, could not sell the truck for a price at least equal to what the Rashes could receive for it.

If anything, a replacement cost valuation will produce a windfall to the creditor in the form of a "cram down premium." Under state law, the creditor is secured to the extent of what it could realize by repossessing and selling the collateral. A replacement cost valuation in the bankruptcy context increases the extent of the creditor's security by awarding it the value of services performed by a dealer, even where the creditor is not a dealer and could not realize such value under any other circumstances. *See* Lawless & Ferris, *supra,* at 18. Thus, a replacement cost valuation contravenes the well-established canon that a party should not receive "a windfall merely by reason of the happenstance of bankruptcy." *Butner v. United States,* 440 U.S. 48, 55 (1979); *Lewis v. Manufacturers Nat'l Bank,* 364 U.S. 603, 609 (1961).

Moreover, this windfall would come at the expense of holders of unsecured claims. Valuing the secured portion of a creditor's claim at the collateral's replacement cost benefits that creditor because it receives a correspondingly

greater portion of the debtor's monthly disposable income. The holders of unsecured claims are correspondingly harmed because there is less disposable income available for them.[24] Indeed, in a situation where a commercial

[24] The deleterious effect of a replacement cost valuation to holders of unsecured claims is evident on the record before us.

Under the plan confirmed by the bankruptcy court, the Rashes propose to pay the trustee $1050.00 per month for 60 months for a total of $63,000.00. The trustee is allocated 10% of this amount for his fee and expenses for a total of $6,300.00. The plan lists two priority claims: (1) the Rashes' attorneys' fees—$2,500.00; and (2) federal taxes due—$2,745.00. Thus, the total amount of priority claims is $5,245.00. The plan lists three secured claims: (1) ACC—$31,875.00; (2) Chrysler Credit Corporation—$3,425.00; and (3) First National Bank of Jasper—$3,500.00. The plan provides that ACC's and First National Bank's claims will be paid over a 58-month period at an annual percentage rate of 9%, meaning that the amount to be paid on account of such claims is $39,426.66 and $4,329.12, respectively. Chrysler's claim will be paid over a 36-month period at an annual percentage rate of 9%, such that the amount to be paid on account of that claim is $3,920.76. Thus, the total amount to be paid on account of the secured claims is $47,676.54. Subtracting the payments for the trustee's fee and expenses, priority claims, and secured claims from the total funds to be paid by the Rashes leaves $3,778.46 available for the unsecured creditors.

The claims filed by ACC, Chrysler, and First National Bank are each only partially secured; that is, each of these creditors has an unsecured claim as well: (1) ACC—$9,296.01; (2) Chrysler —$829.68; (3) First National Bank—$3,470.10. In addition, the claims register indicates that there are other unsecured claims totaling $10,825.91. Therefore, the total of all unsecured claims is $24,421.70. Given the $3,778.46 available to pay these claims, the resulting dividend to the unsecured creditors is approximately 15%.

A replacement cost valuation would increase ACC's secured claim from the amount of the wholesale price—$31,875—to the retail value presented by ACC's expert—$41,000, a difference of $9,125.00. This increase would require shifting the $3,778.46 available to unsecured creditors to satisfaction of ACC's secured claim. Such a shift would leave the unsecured creditors with nothing. Moreover, it would still leave a substantial portion of ACC's secured claim unpaid. This would render the plan not feasible, and as such, it could not be confirmed. 11 U.S.C. § 1325(a)(6). Liquidation under Chapter 7 would follow.

lender to a consumer makes a loan that is undersecured from the outset, *see supra* note 22, the effect of ACC's proposed rule would be to shift some of the debtor's disposable income from one group of unsecured creditors to a creditor who itself made what was in part an unsecured loan. We do not believe that the Bankruptcy Code compels such an odd result. In fact, this is exactly the sort of windfall that bankruptcy is not supposed to produce.[25]

E. Legislative History Analysis

ACC also makes the argument that the legislative history of § 506(a) supports a replacement cost valuation. In this regard, ACC points only to the following excerpt from the Senate Report:

[25] The dissent suggests that a debtor should be indifferent to the award of cram down premiums to secured creditors because it simply involves a change in the recipients of the debtor's disposable income. *Rash*, —— F.3d at —— *7 (Smith, J., dissenting). To the contrary, the debtor has a vital interest in the determination of the amount of a secured claim because, as in this case, it may be the critical difference in whether the debtor's plan is confirmable. *See supra* note 24. While the dissent suggests that this will be a rare occurrence afflicting only marginal plans, *see Rash*, —— F.3d at —— *7 n.6 (Smith, J., dissenting), it is not hard to imagine that many debtors will find their plans in jeopardy when each of the secured claims treated thereunder is inflated by a cram down premium. Further, if a plan such as the Rashes' can be described as "marginal" because it would be rendered infeasible by a $10,000 increase in the amount of a secured claim, then it is a wide margin indeed. Finally, the inability of a debtor to confirm his plan because of these cram down premiums will result in liquidation or dismissal of the debtor's petition, in which the debtor will lose his property *and each secured creditor will be forced to foreclose at whatever price it is able to obtain at a commercially reasonable sale.* In promoting reorganizations under Chapter 13 in lieu of liquidations under Chapter 7, Congress specifically intended to avoid giving creditors this leverage and the concomitant result. *See infra* Part III.E.

> Subsection (a) of this section separates an undersecured creditor's claim into two parts: He has a secured claim to the extent of the value of his collateral; and he has an unsecured claim for the balance of his claim. The subsection also provides for the valuation of claims which involve setoffs under section 553. While courts will have to determine value on a case-by-case basis, *the subsection makes it clear that valuation is to be determined in light of the purpose of the valuation and the proposed disposition or use of the subject property.*

S. Rep. No. 989, 95th Cong., 2d Sess. 68 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5854 (emphasis added). Of course, this passage merely repeats the words of the statute itself. As we have explained at length, this language does not compel a replacement cost valuation.[26]

On the other hand, there is legislative history that strongly suggests that replacement cost is not the appropriate measure of a creditor's secured claim. Most notably, the House Report states:

> The second important change [from current law] is in the treatment of secured creditors. Most often in a consumer case, a secured creditor has a security interest in property that is virtually worthless to anyone but the debtor. The creditor obtains a security interest in all of the debtor's furniture, clothes, cooking utensils, and other personal effects. These items

[26] We have also noted that a replacement cost valuation would effect a departure from pre-Bankruptcy Code practice. *See supra* note 18. The Supreme Court has stated that it is "reluctant to accept arguments that would interpret the Code, however vague the particular language under consideration might be, to effect a major change in pre-Code practice that is not the subject of at least some discussion in the legislative history." *Dewsnup v. Timm*, 502 U.S. 410, 419 (1992). Such discussion is conspicuously absent from the legislative history cited by ACC.

> have little or no resale value. They do, however, have a high replacement cost. The mere threat of repossession operates as pressure on the debtor to pay the secured creditor more than he would receive were he actually to repossess and sell the goods.
>
> Current chapter XIII does little to recognize the differences between the true value of the goods and their value as leverage. Proposed chapter 13 instead views the secured creditor[-]debtor relationship as a financial relationship, and not one where extraneous, non-financial pressures should enter. The bill requires the court to value the secured creditor's interest. To the extent of the value of the security interest, he is treated as having a secured claim . . .

H.R. Rep. No. 595, 95th Cong., 1st Sess. 124 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5787, 6085. Thus, Chapter 13 distinguishes the "true value" of collateral from the value it has as leverage due to the cost of replacing it. Further, it sets the amount of a secured claim equal to the "value of the security interest" so that the debtor is not required "to pay the secured creditor more than he would receive were he actually to repossess and sell the goods." Not only does this history refute the notion that § 506(a) requires a replacement cost valuation when the debtor retains the collateral, but it also conforms to our earlier conclusion that such valuations should start with what the creditor could realize if it repossessed and sold the collateral. *See In re Cook*, 38 B.R. 870, 874 (Bankr. D. Utah 1984) ("A rule requiring valuations under Section 1325(a)(5)(B) to measure the replacement cost of collateral to debtors would defeat the design of Congress by giving secured creditors leverage they were not meant to have."); *see also Grubbs v. Houston First. Am. Sav. Ass'n*, 730 F.2d 236, 249 & n.3 (5th Cir. 1984) (en banc) (stating that current Chapter 13 sought to cure deficiences of the predecessor Bankruptcy Act in part by "permitting modification of the claims of secured creditors

to reduce the creditor's security interest to the actual value of the goods secured," and citing the quoted legislative history concerning 'leverage.' ").

Similar support is found in the legislative history of the redemption provision found in § 722. This section allows the debtor to redeem certain tangible personal property by paying the creditor the amount of its allowed secured claim. 11 U.S.C. § 722; *see supra* note 11. The amount of the secured claim is, of course, determined pursuant to § 506(a). According to ACC's logic, § 506(a) compels a replacement cost valuation in this context because the debtor is retaining the collateral when he redeems it. The legislative history of § 722 suggests otherwise:

> Under [§ 722], the debtor may redeem from a secured creditor property that would be exempt in the absence of the security interest, or property that the trustee abandons, if the debtor pays the secured creditor the allowed amount of the creditor's secured claim. This right amounts to a right of first refusal on a foreclosure sale of the property involved. *It allows the debtor to retain his necessary property and avoid high replacement costs, and does not prevent the creditor from obtaining what he is entitled to under the terms of his contract.*

H.R. Rep. No. 595, 95th Cong., 1st Sess. 127 (1977), *reprinted in* 1976 U.S.C.CA.N. 5787, 6088 (emphasis added). If § 506(a) fixes the creditor's secured claim at the collateral's replacement cost because the debtor is retaining the collateral, the debtor will not be "avoid[ing] high replacement costs" when he pays the creditor the amount of that claim.[27] On the other hand, if the court

[27] Indeed, the version of § 722 in the Senate bill set the redemption price at the fair market value of the property. S. 2266, 95th Cong., 2d Sess. § 722 (1978). This language was rejected in favor of the House provision that set the redemption price at the amount of the creditor's allowed secured claim. H.R. 8200, 95th Cong., 1st Sess. § 722 (1978).

determines the amount of the secured claim by reference to what the creditor could realize by foreclosing on the collateral pursuant to the security agreement, the creditor will "obtain[] what he is entitled to under the terms of his contract."

Further, the legislative history clearly reflects Congress's intent to encourage debtors to use Chapter 13 and make payments to their unsecured creditors, rather than to opt for a Chapter 7 liquidation. The House Report notes that the premises of the Bankruptcy Code "with respect to consumer bankruptcy are that use of the bankruptcy law should be a last resort; [and] that if it is used, debtors should attempt repayment under chapter 13. . . ." *Id.* at 118. Later, the House Report elaborates on the benefits to debtors and creditors offered by Chapter 13 reorganization vis a vis Chapter 7 liquidation:

> The benefit to the debtor of developing a plan of repayment under chapter 13, rather than opting for liquidation under chapter 7, is that it permits the debtor to protect his assets. In a liquidation case, the debtor must surrender his nonexempt assets for liquidation and sale by the trustee. Under chapter 13, the debtor may retain his property by agreeing to repay his creditors. Chapter 13 also protects a debtor's credit standing far better than a straight bankruptcy, because he is viewed by the credit industry as a better risk. In addition, it satisfies many debtors' desire to avoid the stigma attached to straight bankruptcy and to retain the pride attendant on being able to meet one's obligations. The benefit to creditors is self-evident: their losses will be significantly less than if their debtors opt for straight bankruptcy.

Id. The House Report also comments that the bill contains a provision to apprise debtors of the availability of Chapter 13 relief to "encourage and facilitate greater use

of chapter 13 repayment plans by overburdened debtors." *Id.* at 121.[28]

A replacement cost valuation contravenes this intent by artificially increasing the secured portion of the creditor's claim. As the secured portion of the creditor's claim approaches the total amount of that claim, it will make little difference to the debtor whether he bifurcates the claim in bankruptcy or simply reaffirms the debt outside of bankruptcy. Given this indifference, the debtor will likely reaffirm the debt and avoid paying the unsecured claims by opting for Chapter 7. As one bankruptcy court observed:

> To always require retail value would ignore the [interests of unsecured creditors]. In many cases, this would be tantamount to reaffirming the original obligation. That scenario in which secured creditors are paid the full debt on their collateral and unsecured creditors are paid nothing is commonly played out in Chapter 7s. The imposition of an artificially high retail value would bring this preferred treatment into the Chapter 13 confirmation process.

In re Hoskins, 183 B.R. 166, 170 (Bankr. S.D. Ind. 1995). Therefore, we cannot conclude that the Bankruptcy Code demands a valuation standard so contrary to congressional intent to encourage resort to Chapter 13.[29]

[28] This provision is codified at 11 U.S.C. § 342(b), which states:

> Prior to the commencement of a case under this title by an individual whose debts are primarily consumer debts, the clerk shall give written notice to such individual that indicates each chapter of this title under which such individual may proceed.

[29] In addition to this legislative history repudiating a replacement cost standard, we also note that Congress has subsequently rejected a proposed amendment to § 506(a) that would have expressly adopted such a standard. Specifically, the Committee on

Finally, the legislative history of § 506(a) appears to reject any rigid valuation rule such as the one ACC suggests. The Senate Report cited by ACC states that "courts will have to determine value on a case-by-case basis. . . ." S. Rep. No. 989, 95th Cong., 2d Sess. 68 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5854. Similarly, the House Report notes:

> "Value" does not necessarily contemplate forced sale or liquidation value of the collateral; nor does it always imply a full going concern value. Courts will have to determine value on a case-by-case basis, *taking into account the facts of each case and the competing interests in the case.*

H.R. Rep. No. 595, 95th Cong., 1st Sess. 356 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5787, 6312 (emphasis added);[30] *see also Johnson v. General Motors Acceptance*

the Judiciary of the Senate recommended the following changes to that subsection:

> (a) (1) [*sic*] An allowed claim of a creditor either secured by a lien on property in which the estate has an interest or that is subject to setoff under section 553 of this title is a secured claim to the extent of the value of such lien or to the extent of the amount subject to setoff, as the case may be, and, except to the extent that such creditor does not have recourse under any agreement or applicable nonbankruptcy law against the debtor on account of such claim, is an unsecured claim to the extent that the value of such lien or the amount so subject to setoff is less than the amount of such allowed claim.

S. 445, 98th Cong., 1st Sess. § 344(a) (1983). The Senate Report accompanying this bill stated that "the proposed bill specifies the preference of the Code for use of a resale market standard . . ." S. Rep. No. 65, 98th Cong., 1st Sess. 5 (1983). Significantly, this bill was not enacted into law.

[30] ACC argues that this portion of the House Report is irrelevant because the version of § 506(a) in the House bill did not contain the language referring to "proposed disposition or use" and the version of § 506(a) in the Senate bill is the one that was ultimately adopted. We acknowledge this distinction, but note that the House Report simply elaborates on the Senate Report's caveat

Corp. (In re Johnson), 165 B.R. 524, 529 (S.D. Ga. 1994) (quoting this history and noting "§ 506(a)'s aversion to standardized procedure"). The legislative history of the adequate protection provisions, which operate in concert with § 506(a),[31] also emphasizes the ad hoc nature of valuation:

> The section does not specify how value is to be determined, nor does it specify when it is to be determined. These matters are left to case-by-case interpretation and development. In light of the restrictive approach of the section to the availability of means of providing adequate protection, this flexibility is important to permit the courts to adapt to varying circumstances and changing modes of financing.
>
> Neither is it expected that the courts will construe the term value to mean, in every case, forced sale liquidation value or full going concern value. There is wide latitude between those two extremes although forced sale liquidation value will be a minimum.
>
> *In any particular case, especially a reorganization case, the determination of which entity should be entitled to the difference between the going concern value and the liquidation value must be based on equitable considerations arising from the facts of the case.*

S. Rep. No. 989, 95th Cong., 2d Sess. 68 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5840 (emphasis added); *see also In re Hoskins*, 183 B.R. 166, 169 (Bankr. S.D. Ind. 1995) ("[E]ach case hinges upon equitable

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that valuation is a case-by-case inquiry. Moreover, nothing in the Senate Report contradicts the House Report's discussion of § 506(a); rather, the Senate Report merely restates the words of the statute, which, we have held, do not compel a rule requiring a replacement cost valuation when the debtor proposes to retain the collateral.

[31] *See supra* notes 9-10.

considerations arising from the facts of the case. No singular method of valuation may be touted as the appropriate standard.").

By contrast, ACC proposes a fixed rule establishing a valuation standard that applies to a broad class of cases: as a matter of law, replacement cost is the measure of value whenever the debtor retains the collateral.[32] Such a rule is antithetical to the clear congressional intent that valuation should be a case-by-case, fact-specific inquiry. Indeed, one bankruptcy court cautioned against invoking the second sentence of § 506(a) to establish rules contray to this intent:

> This Court believes that the congressional intent behind the enactment of § 506 was to make it clear that the bankruptcy court should consider all factors available to it in arriving at valuations of interests in property. This Court believes that the singling out of one sentence and allowing that to control the entire process of valuation is subverting that congressional intent . . . which is to allow the bankruptcy

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[32] ACC advocates a fixed rule in part because "greater predictability is necessary with respect to the valuation process." ACC Supp. Brief at 26. This need cannot be particularly urgent, however, as courts have conducted valuations under the Bankruptcy Code without a fixed rule since 1978. During this period, the lack of a fixed rule has not impaired the valuation process; in fact, it may have been beneficial. In this regard, Collier notes:

> The comparative paucity of valuation decisions in the context of large corporate cases with substantial amounts of property to be valued is noteworthy. No doubt, with substantial amounts at stake the difficulty of predicting the outcome of a judicial valuation has encouraged parties to achieve consensual resolutions of valuation disputes.

3 Collier ¶ 506.04, at 506-26 n.25; *see also Virginia Nat'l Bank v. Jones (In re Jones)*, 5 B.R. 736, 738 (Bankr. E.D. Va. 1980) ("Verily, it is preferable for the parties, reasonably and realistically, to agree upon such matters as the secured portion of a debt. True value is an elusive Pimpernel. The parties' discretion may be as good as the Court's.").

> court the flexibility to determine values on a case by case basis after due consideration of the facts of each case and the competing interests in that case.

In re Sherman, 157 B.R. 987, 991 (Bankr. E.D. Tex. 1993).

It is true that we also interpret § 506(a) as establishing a rule of sorts by always requiring the court to determine the value of the collateral to the creditor. *See* Part III.C.2. We have qualified this reading, however, by holding that what the creditor could realize at a foreclosure sale is only a *starting point* for the valuation. Consistent with the legislative history, a bankruptcy court may make additions to or deductions from this amount depending upon "equitable considerations arising from the facts of the case." [33]

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[33] For example, deduction of the creditor's foreclosure and disposition costs may not be warranted in some cases. In *Brown & Co. Sec. Corp. v. Balbus (In re Balbus)*, 933 F.2d 246 (4th Cir. 1991), the court refused to subtract hypothetical foreclosure and disposition costs from the stipulated value of the collateral to be retained by the debtor. In so doing, the court noted that the purpose of the valuation was to determine whether the debtor's unsecured claims were less than the $100,000 statutory limit, as set out in 11 U.S.C. § 109(e). *Id.* at 251. Given this purpose, the court made the following observation:

> If hypothetical costs were deducted under § 506(a), then these limitations set out in § 109(e) could be manipulated according to the amount of hypothetical costs determined to be reasonable. This ability to manipulate the limits of § 109(e) on which Congress compromised runs contrary to the purpose of setting specific dollar limitations.

Id. Thus, after considering the legal and factual context of *that case*, the court declined to subtract the hypothetical foreclosure and disposition costs in making its valuation.

This case presents the reverse image of *Balbus*. Whereas the value of the collateral in *Balbus* was stipulated by the parties, that value is the basis of the dispute here—i.e., whether replacement cost is the appropriate measure of the value of the Rashes' truck. On the other hand, while the parties in *Balbus* disputed the deduction of hypothetical foreclosure costs, there is not even any evidence of such costs on this record. *See supra* note 14. As stated previously, we do not have occasion here to address the propriety of deducting foreclosure and disposition costs in a § 506(a) valuation. *Id.*

F. Uniformity Among Circuits

Finally, ACC urges us to adopt its interpretation of § 506(a) because it has been endorsed by all of the other circuits that have addressed the issue. *See Taffi v. United States*, 68 F.3d 306, 309 (9th Cir. 1995), *reh'g en banc granted*, 86 F.3d 147 (9th Cir. 1996); *Metrobank v. Trimble (In re Trimble)*, 50 F.3d 530, 531-32 (8th Cir. 1995); *Winthrop Old Farm Nurseries, Inc. v. New Bedford Inst. for Sav. (In re Winthrop Old Farm Nurseries)*, 50 F.3d 72, 75-76 (1st Cir. 1995); *Huntington Nat'l Bank v. Pees (In re McClurkin)*, 31 F.3d 401, 405 (6th Cir. 1994); *Lomas Mortgage USA v. Wiese*, 980 F.2d 1279, 1286 (9th Cir. 1992), *vacated on other grounds*, 508 U.S. 958 (1993); *Coker v. Sovran Equity Mortgage Corp. (In re Coker)*, 973 F.2d 258, 260 (4th Cir. 1992); *Brown & Co. Sec. Corp. v. Balbus (In re Balbus)*, 933 F.2d 246, 251-52 (4th Cir. 1991). *But see General Motors Acceptance Corp. v. Mitchell (In re Mitchell)*, 954 F.2d 557, 560 (9th Cir.), *cert. denied*, 506 U.S. 908 (1992). In making this argument, ACC primarily stresses the importance of uniformity among the circuit courts of appeals.

First, we note that four of these cases—*McClurkin, Lomas, Coker,* and *Balbus*—concern only the issue of whether § 506(a) requires a court to deduct the creditor's (or debtor's) hypothetical foreclosure and disposition costs from the otherwise undisputed value of real property securing a loan. By contrast, the deductibility of ACC's foreclosure and disposition costs is *not* an issue in this case—there is no evidence related to these costs—and the value of the collateral *is* otherwise in dispute.[34] As such, these four cases do not address the primary issue in

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[34] *See supra* notes 14, 33.

this case, which is whether § 506(a) compels a replacement cost valuation when the debtor proposes to retain the collateral. Therefore, they do not directly endorse the interpretation urged by ACC. The other three cases—*Taffi, Trimble,* and *Winthrop*—all followed the panel opinion in this case, which was the first circuit court opinion to employ the "replacement cost" valuation standard and has since been vacated, 68 F.3d 113 (5th Cir. 1995).

Second, to the extent that the cases cited by ACC are in conflict with our interpretation of § 506(a), we simply disagree with them. In so doing, we do not ignore the need for uniformity among circuits. Indeed, in some circumstances, it may be more important to preserve that uniformity even though it requires us to adhere to an arguably incorrect result. In this case, however, the need to reach the correct result in this circuit is paramount. As the number of amicus briefs filed in this court reflects, the valuation of the secured portion of an undersecured creditor's claim in the context of a Chapter 13 cram down has substantial economic impact not only on the Rashes and their creditors, both secured and unsecured, but also on all Chapter 13 debtors and their creditors in this circuit. The interpretation of § 506(a) subscribed to by these other circuits materially alters the congressional design in providing the reorganization alternative by distorting the economic relationship between the holders of secured and unsecured claims and by creating a disincentive for debtors to elect the Chapter 13 remedy. We cannot join our sister circuits in an interpretation of § 506(a) that so disserves an important congressional objective.

IV. CONCLUSION

In sum, we hold that § 506(a) of the Bankruptcy Code does not compel a bankruptcy court to value collateral at its replacement cost to the debtor when the debtor proposes to retain the collateral as part of his reorganization plan. The language of the statute does not provide the

clear textual guidance necessary to justify the departure from state law effected by a replacement cost valuation. Moreover, such a standard does not accurately reflect the economic relationship between a debtor and his creditor. Finally, there is not support in the legislative history for a replacement cost rule. Rather, the statutory language, economic considerations, and the legislative history indicate that a valuation of a secured creditor's interest under § 506(a) should start with what the creditor could realize if it repossessed and sold the collateral pursuant to its security agreement, taking into account the purpose of the valuation and the proposed disposition or use of the collateral. Bankruptcy courts may make adjustments to this amount depending upon considerations arising from the facts of the particular case.

In this case, the bankruptcy court valued the Rashes' truck at its wholesale price, reasoning that this price reflected what ACC could obtain if it repossessed and sold the truck. The court based this finding on credible expert testimony from the valuation hearing. In addition, the court did consider that the purpose of the valuation was to determine the distribution ACC was entitled to receive under the Rashes' plan pursuant to § 1325(a)(5)(B). The court also considered that the Rashes were using the truck for its intended purpose and that the truck was insured and maintained. Accordingly, we do not believe that the court erred in determining the truck's value.

For the foregoing reasons, the judgment of the district court affirming the judgment of the bankruptcy court is

AFFIRMED.

JERRY E. SMITH, Circuit Judge, with whom REYNALDO G. GARZA, DUHÉ, BARKSDALE, EMILIO M. GARZA and DEMOSS, Circuit Judges, join, dissenting:

The majority dismantles 11 U.S.C. § 506(a) (1994) by combining a question-begging interpretation of the statute's first sentence with an unreasonably restrictive reading of the second. Having thereby obscured the section's plain meaning, the majority turns to an inapposite presumption, an incorrect economic analysis, and the last resort of judicial redrafting—selective reading of the legislative history. Not surprisingly, this policy-driven reconstruction of the statute has been squarely rejected by every other circuit that has considered it. I respectfully dissent.

Section 506(a) is not difficult to interpret. Read as a whole, it plainly means that when a reorganizing debtor retains and uses collateral, we must value the property according to its worth to the debtor (the *actual* user), not to the creditor (a *purely hypothetical* seller).

The section's first sentence states that an allowed secured claim "*is a secured claim to the extent of the value of* such creditor's interest in the estate's interest in *such property*." § 506(a) (emphasis added). This sentence means that the value of a secured claim is simply the value of the collateral. *See, e.g., United Sav. Ass'n v. Timbers of Inwood Forest Assocs.*, 484 U.S. 365, 372 (1988). The sentence's language is a bit obtuse, as the creditor might have a security interest in only part of the property, or the debtor might have an ownership interest in only part. In such a case, the allowed amount of the secured claim is equal to a portion of the value of the collateral. *See PSI, Inc. v. Aguillard (In re Senior-G & A Operating Co.)*, 957 F.2d 1290, 1301 (5th Cir. 1992).

The first sentence of § 506(a), therefore, tells us only that the amount of a secured claim is the value of the collateral; it does not tell us how to determine that value.

The section's second sentence tells us that "[s]uch value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property." In this case, the purpose is cramdown of property to be retained in a chapter 13 reorganization, and the "disposition or use" is continued use by the debtor. Thus, we must "determine[]" the value of the property in the hands of the debtor, not on the auction block.

Deducting *purely hypothetical* costs of sale from the collateral's value ignores both the purpose of the valuation and the property's proposed disposition or use. As five circuits understand,

> [W]here a debtor intends to retain and use the collateral, the purpose of the valuation is to determine the amount an undersecured creditor will be paid for the debtor's continued possession and use of the collateral, not to determine the amount such creditor would receive if it hypothetically had to repossess and sell the collateral. Such an interpretation ignores the express dictates of section 506(a).

Metrobank v. Trimble (In re Trimble), 50 F.3d 530, 532 (8th Cir. 1995). Thus, we must determine the value of collateral to the debtor, as measured by its replacement cost to him.[1]

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[1] In one sense, of course, an asset is often "worth" more than its cost. We need not determine the actual utility a debtor derives from collateral, however, as any particular piece of property is worth no more than its replacement cost. For example, having a truck to drive might be worth far more to an individual than it would cost him to purchase one, but any particular truck is worth no more than it would cost him to buy its equivalent. Thus, the value of retained collateral is equal to its replacement cost. *See United States v. Marmolejo*, No. 94-60812, 1996 WL 327636, at *6 (5th Cir. June 13, 1996) (holding that value of item equals price willing buyer would pay willing seller for it); A. MITCHELL POLINSKY, AN INTRODUCTION TO LAW AND ECONOMICS 135 (2d ed. 1989) (observing that value to individual of standardized good

The underlying economic reality—that collateral is worth more in a reorganization than in a liquidation because a liquidation sale understates the property's true worth—is a familiar one.[2] In fact, we have observed en banc that "[t]he secured creditor benefits from a successful reorganization because its secured claim is valued on a going-concern basis in connection with a plan of reorganization, and the secured creditor is not compelled to liquidate its collateral at forced-sale prices." *United Sav. Ass'n v. Timbers of Inwood Forest Assocs. (In re Timbers of Inwood Forest Assocs.)*, 808 F.2d 363, 373 (5th Cir. 1987) (en banc), *aff'd*, 484 U.S. 365 (1988). As the First Circuit explained,

> By retaining collateral, a Chapter 11 debtor is ensuring that the very event [the debtor] proposes to use to value the property—a foreclosure sale—will not take place . . . . Under such circumstances, a court remains faithful to the dictates of § 506(a) by valuing the creditor's interest in the collateral in light of the proposed post-bankruptcy reality: no foreclosure sale and economic benefit for the debtor derived from the collateral equal to or greater than its fair market value.

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sold in market is good's market price); *infra* part III.C (discussing meaning of "value").

In general, replacement cost equals an asset's retail price, and foreclosure value equals its wholesale price, which is equivalent to the retail price less hypothetical costs of sale. There are, however, instances in which an individual debtor could acquire replacement property for less than retail, or a creditor could resell property for greater than wholesale. Thus, the terms "retail" and "wholesale" value only loosely describe the replacement and foreclosure approaches.

[2] *See Senior-G & A Operating*, 957 F.2d at 1301 (valuing well according to revenues to be derived from future production); *Brite v. Sun Country Dev. (In re Sun Country Dev.)*, 764 F.2d 406, 409 (5th Cir. 1985) (valuing notes given to secured creditor in light of promised payments rather than resale value).

Winthrop Old Farm Nurseries v. New Bedford Inst. for Sav. (In re Winthrop Old Farm Nurseries), 50 F.3d 72, 75 (1st Cir. 1995).

In light of these important differences between reorganization and foreclosure, the canon of construction disfavoring displacement of well-established areas of state law is inapposite. The Constitution has prevented states from enacting laws regarding bankruptcy reorganizations for the past 207 years, *see* U.S. Const. art. I, § 8, cl. 4; thus, there is simply no well-established state law on point. Moreover, both the canon and the ambiguous legislative history are irrelevant, as we may not look beyond § 506's plain meaning. *See United States v. Ron Pair Enters.*, 489 U.S. 235, 241 (1989).

In short, there are two primary reasons that we must determine the value of collateral in the hands of the debtor, not on the auction block: First, "to do otherwise would be to completely erase the second sentence of the statute"; and second, "it is contradictory to allow the debtor to keep the [collateral] but value the secured portion based upon a hypothetical sale." *Lomas Mortgage USA v. Wiese*, 980 F.2d 1279, 1286 (9th Cir. 1992), *vacated on other grounds*, 508 U.S. 958 (1993).

I.

Before turning to statutory construction, I emphasize that the other five circuits that have addressed this question all followed the replacement approach. This uniformity of appellate authority is significant both as compelling support for the replacement approach and because, as I explain below, national uniformity is particularly important in this area of law.

A.

The First and Eighth Circuits interpreted § 506(a) after we issued our panel opinion in this case,[3] and both cited our decision with approval. *See Trimble,* 50 F.3d at 531 ("We adopt the reasoning of the Fifth Circuit in *In re Rash* . . . ."); *Winthrop,* 50 F.3d at 74 (agreeing with "four Circuit Courts, [that] have . . . declined to value collateral that a debtor proposes to retain based on a hypothetical foreclosure sale"). The Fourth and Sixth Circuits reached the same result for the same reasons before our panel decision. *See Huntington Nat'l Bank v. Pees (In re McClurkin),* 31 F.3d 401, 405 (6th Cir. 1994) ("[W]e . . . hold that, where the debtor proposes to retain the collateral under a reorganization plan, § 506(a) does not require or permit a reduction in the creditor's secured claim to account for purely hypothetical costs of sale"); *Coker v. Sovran Equity Mortgage Corp. (In re Coker),* 973 F.2d 258, 260 (4th Cir. 1992) (stating that *Brown & Co. Sec. Corp. v. Balbus (In re Balbus),* 933 F.2d 246 (4th Cir. 1991), "controls" its decision that hypothetical costs of sale may not be deducted when a debtor retains collateral).

Prior to our panel opinion, the Ninth Circuit initially adopted the foreclosure approach, *see General Motors Acceptance Corp. v. Mitchell (In re Mitchell),* 954 F.2d 557 (9th Cir.), *cert. denied,* 506 U.S. 908 (1992), but later refused to deduct hypothetical costs of sale on the ground that "it is contradictory to allow the debtor to keep the [collateral] but value the secured portion based upon a hypothetical sale," *Lomas Mortgage,* 980 F.2d at 1286. Most recently, that circuit observed that "[t]he growing number of circuits to have considered this issue

[3] *See Associates Commercial Corp. v. Rash (In re Rash),* 31 F.3d 325 (5th Cir. 1994) (employing replacement valuation), *modified,* 62 F.3d 685 (5th Cir.), *reh'g en banc granted,* 68 F.3d 113 (5th Cir. 1995).

have all concluded that hypothetical costs of sale should not be deducted," and chose to "adopt" *Lomas Mortgage* because "it is especially important not to reverse ourselves and create an intercircuit conflict." [4] The court therefore severely limited, if it did not actually overrule, *Mitchell* in order to avoid a circuit split. *See id.* at 310 ("*Mitchell* did not address whether [hypothetical costs of sale] should be deducted when the debtor retained the [property]."). In short, the last two circuits to address this question—the First and the Ninth—found that the circuits were uniform, and the Ninth eviscerated one of its own precedents in order to avoid "creat[ing]" a conflict.[5]

B.

The Ninth Circuit is correct that it is particularly important to retain uniformity on this issue, as our decision will affect primarily the relative costs of secured and unsecured credit, *not* the well-being of bankrupt debtors. A reorganizing debtor must pay *all* of his disposable income to his creditors for, at most, three to five years. *See* 11 U.S.C. § 1325(b)(1)(B) (1994); 11 U.S.C. § 1322(c) (1994). Thus, he is unaffected by the amount of his

[4] *Taffi v. United States (In re Taffi),* 68 F.3d 306, 309-10 (9th Cir. 1995), *reh'g en banc granted,* 86 F.3d 147 (9th Cir. 1996).

[5] The majority attempts to distinguish four of the circuit court authorities—*McClurkin, Lomas Mortgage, Coker,* and *Balbus*—by observing that the debtors in those cases argued that the "creditor's interest in the estate's interest" includes a reduction for hypothetical costs of sale, rather than arguing that the value of "[the] property" includes such a reduction. *See maj. op.* at 56-57. That conceptual distinction is irrelevant: All four cases hold that we may not reduce the value of security by considering purely hypothetical costs of sale. *See McClurkin,* 31 F.3d at 405; *Lomas Mortgage,* 980 F.2d at 1286; *Coker,* 973 F.2d at 260 (discussing *Balbus*). Absent unusual circumstances, replacement value equals the property's full market value, while foreclosure value equals market value reduced by hypothetical costs of sale. *See supra* note 1.

income that goes to secured rather than unsecured creditors.[6]

The choice between the foreclosure and replacement approaches does favor either secured or unsecured creditors *vis-á-vis* the other, however. The foreclosure approach benefits unsecured creditors by reducing the value of secured claims, thereby freeing up more money for unsecured claims; the replacement approach does the opposite. Both types of creditors can largely compensate for either result by adjusting their interest rates or other lending practices, such as down payment requirements, accordingly. *See infra* p. 30. As a result, adoption of either rule will produce counterbalancing effects on the interest rates charged by secured and unsecured creditors,

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[6] Decreasing the value of collateral might make an otherwise infeasible reorganization feasible, but only rarely. A plan must provide all secured creditors with either their collateral or the allowed amounts of their secured claims, *see* § 1325(a)(5), and a debtor's disposable income might occasionally be sufficient to cover the allowed amounts after, but not before, deduction of hypothetical costs. Such a reorganizing debtor could simply surrender the collateral, *see* § 1325(a)(5)(C), but if he uses it to produce income, the loss might prevent him from meeting other obligations. (Coincidentally, this might be such a case. *See* maj. op. at 44-45 n.24.).

Needless to say, it is unlikely that this scenario will recur frequently. In addition, most chapter 13 reorganizations fail, *see* William C. Whitford, *The Ideal of Individualized Justice*, 68 Am. Bankr. L.J. 397, 4 10-11 (1994); TERESA A. SULLIVAN ET AL., AS WE FORGIVE OUR DEBTORS 215-17 (1989), and a reorganization that is so marginal from the beginning is not likely to be among the few that succeed.

Moreover, decreasing the value of collateral could actually prevent compliance with another Chapter 13 requirement: that total unsecured debt not exceed a prescribed statutory amount. *See* 11 U.S.C. § 109(e) (1994). As a secured creditor's claim is unsecured to the extent that it is not secured, *see* § 506(a), decreasing the value of security increases the amount of unsecured claims, pushing the debtor closer to the statutory cap. Thus, replacement valuation thwarts few, if any, reorganizations that would otherwise succeed, and might even enable others to do so.

resulting in little net effect on consumers. Thus, the primary impact of the majority opinion will be the creation of an artificial interest rate differential between our states and those in the First, Fourth, Sixth, Eighth, and Ninth Circuits.[7]

II.

A.

The first sentence of § 506(a) states that a creditor's allowed secured claim "*is a secured claim to the extent of the value of* such creditor's interest in the estate's interest in *such property*" (emphasis added). This sentence means that "[i]n situations involving only one creditor and one debtor, the value of the . . . secured claim is simply the value of the underlying collateral." *Sandy Ridge Dev. Corp. v. Louisiana Nat'l Bank (In re Sandy Ridge Dev. Corp.),* 881 F.2d 1346, 1349 (5th Cir. 1989). Congress used the qualifier "creditor's interest in the estate's interest in" only because a creditor or debtor sometimes has an interest in less than the full value of collateral. As the majority recognizes, a creditor may have only a partial lien on collateral, or a debtor may have only a partial ownership interest in it. In such a case, the allowed secured claim is the value of the property reduced by the product of the creditor's and the debtor's percentage interests. *See Senior-G & A Operating,* 957 F.2d at 1301 (interpreting "creditor's interest in the estate's interest" as referring to a *percentage interest* in the value of the collateral).

In fact, the Supreme Court twice has said that the "creditor's interest in the estate's interest in such property"

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[7] In addition, creation of a cricuit split will undoubtedly aggravate the unpredictability of adjudication in circuits that have not decided the question. Lower court decisions are all over the map, *see In re Maddox*, 194 B.R. 762, 765-67 (Bankr. D.N.J. 1996) (surveying the caselaw), fostering uncertainty and making it difficult for debtors and creditors to assess the cost and value of credit. Maintaining the 6-0 circuit count could have led to greater consistency.

means "the value of the collateral." [8] The first sentence of § 506(a) therefore tells us *only* that the allowed amount of the secured claim is equal to a portion of the value of "such property"; it tells us what is to be valued, not how to value it.[9]

The majority asserts, without even mentioning § 506 (a)'s second sentence, that "the creditor's interest is in the nature of a security interest, giving the creditor the right to repossess and sell the collateral and nothing more." Maj. op. at 17. In doing so, the majority turns a blind eye on the statute it supposedly interprets and simply assumes the answer to its own question.

The section's second sentence states that we must determine the value of the "creditor's interest in the estate's interest in such property" contextually, "in light of the purpose of the valuation and of the proposed disposition or use of such property." Before even considering those factors, however, the majority arbitrarily decides that the value will *always* equal that of the right to foreclose.

Obviously, secured creditors have whatever rights the Bankruptcy Code grants them. The majority is correct that the right to foreclose is the *primary* attribute of a security interest, and in a state-court action, a chapter 7 liquidation, or a chapter 13 reorganization in which the debtor chooses not to retain the property, it may be the creditor's only recourse. But we cannot simply *assume* that § 506(a) values *all* secured claims at foreclosure value.

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[8] *See Nobelman v. American Sav. Bank*, 508 U.S. 324, 328-29 (1993) (stating that § 506(a) provides that a claim is secured "to the extent of the value of [the] property"); *Timbers*, 484 U.S. at 372 ("The phrase 'value of such creditor's interest' in § 506(a) means 'the value of the collateral.'").

[9] The majority's observation that we need not value the "estate's interest" is therefore correct but irrelevant. We must value "such property," and the question is whether to do so from the debtor's or the creditor's perspective.

The majority twists the section's language by contending that "the estate's interest in such property" is simply the object of the phrase "creditor's interest in." As the majority concedes, however, the parallelism of the terms "creditor's interest" and "estate's interest" indicates that they should play similar roles. *See* maj. op. at 15. Thus, "such creditor's interest in the estate's interest in" qualifies the object "such property." As explained above, that qualifier determines the portion of "such property" covered by the security interest.

In fact, even isolating "creditor's interest" as the supposed key term of the paragraph gets the majority nowhere, for the Bankruptcy Code does not define that term. Thus, the majority finds itself where it began—assuming its own conclusion.

In addition, common usage of the term "interest" is hardly limited to foreclosure rights. In construing a similarly-worded section of the Code, the Supreme Court observed that "[t]he term 'interest in property' certainly summons up such concepts as 'fee ownership,' 'life estate,' 'co-ownership,' and 'security interest' *more readily than it does the notion of 'right to immediate foreclosure.'*" *Timbers*, 484 U.S. at 371 (emphasis added).[10]

Finally, we must read § 506(a) as a whole:

> The purpose of [the phrase "to the extent of the value of such creditor's interest in the estate's interest in such property"] appears to care for the problem where the estate's interest is less than full ownership . . . . If [that phrase] were interpreted to mean that the value must be fixed at the amount which the creditor would receive on foreclosure, then the last sentence of the statute . . . would be surplusage.

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[10] The majority attempts to reconcile its holding with *Timbers* by implying that it simply modifies the Court's construction of § 506(a)'s first sentence. *See* maj. op. at 18. Changing "the value of the collateral" to "the value of the collateral to the creditor" is akin to slipping the New Testament into the back of the Torah.

> Such an interpretation would mean that the value should always be fixed at the amount which the creditor would receive upon foreclosure regardless of the purpose of the valuation and of the proposed disposition or use of the property . . . . It is not appropriate for the court to ignore or give no effect to the language of the last sentence of the statute.

In re Courtright, 57 B.R. 495, 497 (Bankr. D. Or. 1986). Accordingly, § 506(a)'s first sentence commands us to value a portion of the property, not "such creditor's interest," whatever that expression might mean in isolation.

B.

Section 506(a)'s second sentence establishes the method for determining value: "Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property." As the majority observes, "[s]uch value" refers to "the value of such creditor's interest in the estate's interest in such property." *See* maj. op. at 19.

1.

The majority correctly notes that valuation for one purpose may differ from that for another because it is necessarily contextual. *See id.* at 20-22. In this case, the *actual* purpose is to determine the value of property retained in a chapter 13 reorganization, not to determine the value of collateral in a hypothetical liquidation or in a reorganization in which the debtor proposes to sell it.

The majority contends that replacement valuation would destroy the "apparent symmetry" of § 1325(a)(5), which requires that a secured creditor either (1) accept the plan; (2) receive at least "the allowed amount" of his claim, as defined by § 506(a), and a lien over the security; or (3) receive the collateral immediately. *See id.* at 24. One problem with this assertion is that neither replacement *nor* foreclosure valuation always renders the latter two options equally appealing to a creditor.

Foreclosure valuation provides a secured creditor with the equivalent of immediate foreclosure only if the debtor makes all scheduled payments over the three-to-five year life of the plan. The vast majority of reorganizations fail, however, *see supra* note 6, leaving creditors with only a fraction of the compensation due them. In a case such as this, where the collateral depreciates rapidly, the secured creditor may receive far less in a failed reorganization than in a prompt foreclosure. Even with a non-depreciating asset, such as land, its market value may change during the course of a reorganization, subjecting the secured creditor to unwanted speculative risk. *Cf.* Todd J. Zywicki, *Cramdown and the Code*, 19 T. MARSHALL L. REV. 241, 260 (1994) (noting that cramdown subjects creditors to additional risk by reducing any "equity cushion" intended to protect against depreciation).[11]

Moreover, a sucessful reorganization produces a surplus (relative to liquidation or foreclosure) by allowing the debtor to retain the collateral. The debtor benefits by keeping his property, of course; his creditors benefit from pocketing any income that he generates thereby and from avoiding the transaction costs of resale.

This financial surplus must be divided between secured and unsecured creditors. It makes perfect sense to award much of the surplus to secured creditors, as it exists only because of their collateral. Therefore, even if there were a valuation method that made secured creditors indifferent between foreclosure and reorganization, it is not intuitive that their "secured amount" should be the same in each instance. In short, we must keep our eye on the ball: The purpose of the valuation is to determine the value of property retained by a debtor, not sold by a creditor.

[11] In addition, the state law right to accept and retain collateral in satisfaction of a debt is sometimes more valuable than the right to foreclose. *See infra* pp. 21-22. Thus, it is not evident that foreclosure provides an appropriate baseline for valuing the right to immediate possession.

2.

The "proposed dispositon or use" of the property is continued use by the debtor, not a sale by the creditor. Accordingly, we must value the collateral "in light of" its worth to the debtor, not the price it would fetch at a purely hypothetical foreclosure sale. That is to say,

> [S]ince the Debtor's Plan provides for it to retain the Property, the value of Bank's interest in the Debtor's interest in the Property should be determined without regard for the hypothetical costs that may be incurred by Bank if it gets the Property back. Why? Because it is not getting the Property back. Valuation under § 506 must be with a view to the proposed disposition of the Property.

In re Spacek, 112 B.R. 162, 164 (Bankr. W.D. Tex. 1990).

The majority responds to this remarkably plain—and dispositive—text with an impressive *quantity* of arguments. Taken together, the majority's nimble ruminations reduce § 506(a)'s command to determine value in light of the property's proposed disposition or use to a suggestion that disposition or use will, at most, be somewhat relevant from time to time. This extremely restrictive reading collides with the related canons of statutory construction that we must read a statute holistically, interpreting each of its portions in light of the others, *see Timbers*, 484 U.S. at 371, and must construe the entire statutes "in such fashion that every word has some operative effect," *United States v. Nordic Village, Inc.*, 503 U.S. 30, 36 (1992). In short, the majority's reconstruction of the statute is too strained to be credible.

a.

The majority contends that replacement valuation would create an "exception" to the first sentence by looking to the value of the estate's interest, rather than the creditor's

interest. *See* maj. op. at 28-29. Of course, this contention rests upon the majority's misreading of the first sentence, taking the term "creditor's interest" out of context and subverting the remainder of the section to an assumed meaning of that term. It is also untrue, for the replacement approach values "such property," not the creditor's or estate's interest. *See supra* note 9. Finally, observe the majority's methodology: Instead of taking the statute as a whole, it reads the first sentence in a vacuum and then interprets the second restrictively on the ground that a more natural construction would conflict with its reading of the first.

Similarly, the majority argues that because the second sentence references the phrase "the value of such creditor's interest in the estate's interest in such property," we should consider *only* those dispositions or uses that detrimentally affect the price that collateral would fetch at a foreclosure sale. *See* maj. op. at 30-31. In doing so, however, the majority again assumes that the first sentence limits the "allowed amount" to hypothetical foreclosure value.

In addition, § 506(a) does not require that only harmful uses be considered. Instead, it states categorically that value shall be determined "in light of . . . the proposed disposition or use," implying that disposition or use is relevant in every case. The majority's assertion that Congress required consideraton of two specific factors, even though one would seldom matter, stretches credulity.

Finally, the majority insists that even though § 506(a) requires that value *"shall be determined* in light of the purpose of the valuation and of the proposed disposition or use" (emphasis added), courts need only *consider* the latter factor, and may then set it aside when actually determining value. *See* maj. op. at 29-30. To the extent that the majority observes only that disposition or use will not actually affect value in every case, it is undoubtedly right: If the debtor and creditor would each put an asset to the same use, and each would have to pay the

same amount to replace it, then it has the same value to them.

The majority attempts to ratchet this common sense observation into an assertion that using foreclosure valuation would not deprive § 506(a)'s second sentence of effect. Of course, "disposition or use" would continue to be relevant for those purposes for which the majority wants it to be, e.g., when the property is actually sold at a foreclosure sale or when a detrimental use would affect a hypothetical foreclosure sale price. In all other cases, however, the majority would have a judge "consider" the proposed disposition or use and then ignore it. In any other context, that would be not only error, but abuse of discretion.

The majority therefore finds itself giving a remarkably strained reading to § 506(a)'s second sentence, permitting judges to "consider" an asset's "proposed disposition or use" but arbitrarily limiting their ability to base their determinations upon it. This construction becomes possible only if one *assumes* that (1) § 506(a) only references a Platonic foreclosure remedy rather than defining *de novo* the value of an allowed secured claim; and (2) the second sentence has only limited meaning, subjugated to a rigid reading of the first. To the contrary: (1) Section 506(a) expressly sets out to define the amount of an allowed secured claim and refers to the value of a portion of "such property," not foreclosure; and (2) the second sentence plainly requires courts to determine value in light of two specific factors.

To conclude,

> Those courts which hold that hypothetical costs should be deducted generally do so by focusing on the first sentence of § 506(a), virtually ignoring the debtor's proposed disposition of the collateral and the requirements of the second sentence of § 506(a).

Balbus, 933 F.2d at 251. Unfortunately, our circuit is now such a court.

b.

By way of a counter-offensive, the majority contends that foreclosure valuation is no more hypothetical than replacement valuation, because both postulate a nonexistent transaction. *See* maj. op. at 27-28. In doing so, the majority confuses evidence with substance. As an evidentiary matter, any valuation method must postulate the price at which retained property would be bought or sold. In terms of substance, however, the replacement approach considers the *actual* value of the property to the person who *actually* possesses it; replacement cost is simply a measurement of that value. *See supra* note 1. On the other hand, the foreclosure approach uses a hypothetical transaction to define value, not to measure it.

Finally, the majority argues that even if it were to consider the proposed disposition or use of the collateral, it would not necessarily have to consider the collateral's value to its possessor. *See* maj. op. at 26-27. On first blush, such a construction would once again give remarkably little meaning to the clause, requiring courts to deduct costs that are not incurred in the actual use of property and would turn our consideration of "proposed disposition or use" into a mere formality.

If we were to value property from the perspective of someone with no right to possess it, however, we would still need to determine its value to that person in light of its proposed disposition or use—possession by the debtor. Collateral would then have two types of value to a secured creditor: first, future foreclosure value; and second, secondary benefit from its utility to the debtor, e.g., a share of any income the property enabled the debtor to make.

Because foreclosure valuation considers only the former component of value, it is too stingy, even from this odd perspective. In addition, the amount of the latter component of value would depend in part upon the allowed

amount of the secured claim, bringing us back to to where we started. Thus, the majority's reasoning is circular.

C.

The majority asserts that because the text of the Bankruptcy Code must "clearly compel" departures from state law, and the replacement approach modifies the extent of ACC's security relative to Texas law, Congress may enact replacement valuation only by drafting text that "clearly compel[s]" that result. *See* maj. op. at 11-12. In doing so, the majority stretches a simple canon of construction beyond all recognition.

Interpretation of the Bankruptcy Code is no different from the construction of any other statute. Thus, "where the meaning of the Bankruptcy Code's text is itself clear, its operation is unimpeded by contrary state law or prior practice." *BFP v. Resolution Trust Corp.*, 114 S. Ct. 1757, 1765 (1994) (internal quotation and citation omitted).

The canon of construction relied upon by the majority states that the Bankruptcy Code should not be read to overrule a long-established tradition of state law protecting an important state interest unless Congress's intent to "displace" state law is "clear and manifest." *Id.* at 1764-65. Thus, we presume that property rights are defined by state law, *see Butner v. United States*, 440 U.S. 48, 54-55 (1979), for otherwise the legal owner of property under state law could differ from the legal owner under federal law—a patently absurd result.[12]

[12] *Cf. BFP*, 114 S. Ct. at 1765 (noting that departure from state fraudulent transfer law would mean that "the title of every piece of realty purchased at foreclosure would be under a federally created cloud"). Similarly, we presume that Congress does not intend to grant trustees exemptions from non-bankruptcy law, i.e., laws of general applicability. *See California State Bd. of Equalization v. Sierra Summit, Inc.*, 490 U.S. 844, 851-52 (1989) (taxes); *Midatlantic Nat'l Bank v. New Jersey Dep't of Envtl. Protection*, 474 U.S. 494, 501 (1986) (environmental laws). Such exemptions would create a direct conflict, as conduct that is generally illegal under state or federal law—such as abandoning polluted land or not paying taxes—would be permitted, perhaps even required, by the Bankruptcy Code.

Replacement valuation would not "displace" a well-established area of state law, for the simple reason that there is no state law regarding the rights of secured creditors in reorganizations. In fact, the Constitution has prevented the states from passing such laws for the past 207 years.

The majority's reliance upon *BFP* would have some force if this were a chapter 7 liquidation or a reorganization in which the debtor did not propose to retain the secured property, as those situations generally involve sale of collateral and therefore present a closer analogy to state-law foreclosure. As noted above, however, reorganizations subject secured creditors to risks that are not present in straight foreclosures, and successful reorganizations generate surpluses for creditors. *See supra* p. 13. Thus, there is *no* analogous state law to "displace."[13] As a result, the Supreme Court has readily interpreted the plain language of § 506 to grant secured creditors rights in reorganizations that they do not have in state-law foreclosures. *See Rake v. Wade*, 508 U.S. 464 (1993) (interpreting plain language of § 506 to grant postpetition interest to oversecured creditors in chapter 13 proceedings.)

Finally, even if state law on foreclosure were relevant, foreclosure valuation would displace it as well. As one bankruptcy court explained,

> [F]oreclosure is only one way to realize the value of a lien. Other methods include allowing the debtor to

[13] The majority's extension of the canon creates a sort of double-secret preemption: Federal law prohibited the states from passing laws differentiating reorganizations from foreclosures, and the absence of such state laws requires us to assume that Congress did not intend to do so.

> discharge the lien over a period of time by making installment payments, awaiting a sale of the collateral by the debtor, or obtaining a deed in lieu of foreclosure. None of these options would require the creditor to "eat" the cost of a forced sale. Thus the deduction of hypothetical sale costs, which ironically is premised on what would happen in the "real world," ignores the very real possibility that a foreclosure sale could prove unnecessary, and instead assumes a worst-case scenario from the creditor's perspective.

In re Jones, 152 B.R. 155, 185 (Bankr. E.D. Mich. 1993).

In fact, both Texas law and the Uniform Commercial Code permit a creditor to accept and retain his collateral in satisfaction of the debt. *See* TEX. BUS. & COM. CODE § 9.505(b) (1991). In a reorganization, the creditor loses that right, which is sometimes more valuable than the right to foreclose: The creditor might put the property to productive use, hold onto it for speculative purposes, or desire to take it outright and sell it later without the technical requirements of foreclosure sales. In fact, this retention remedy cannot always be equivalent to the foreclosure one, for if it were, the drafters would have excluded it as redundant.

Consequently, it is the very nature of reorganization, *not* the choice between valuation methods, that overrides state law. Respect for state law, while laudable, provides no excuse for not reading § 506(a) according to its plain meaning.

D.

Consideration of legislative history is inappropriate, because the language of the statute is plain. *See United States v. Barlow,* 41 F.3d 935, 942 (5th Cir. 1994) (stating that when statutory language is plain or unambiguous, we may not resort to examination of legislative history), *cert. denied,* 115 S. Ct. 1389, and *cert. denied,* 115 S. Ct. 1804, and *cert. denied,* 115 S. Ct. 1804 (1995). Moreover, as is often the case, different portions of the legislative history can be construed to support diverse outcomes.

1.

The Senate report emphasizes the importance of § 506(a)'s second sentence: "While courts will have to determine value on a case-by-case basis, the subsection makes it clear that valuation is to be determined in light of the purpose of the valuation and the proposed disposition or use of the subject property." S. REP. No. 989, 95th Cong., 2d Sess. 68 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5854. This passage emphasizes that purpose and proposed disposition or use are the two factors that "clear[ly]" must be considered when "determin[ing] value."

In addition, the majority correctly notes that the original House bill did not specify that value shall be determined in light of purpose and proposed disposition or use. *See* maj. op. at 52 n.30. The conference, however, chose to include this provision in the final legislation. Thus, legislative history buffs could easily conclude that the sentence is an important one, specifically considered by Congress, and deserving of more than minimal significance.

The majority shrugs these portions of the legislative history aside, noting that the Senate report merely repeats the words of the statute. *See* maj. op. at 47. While that is true, the history's emphasis on § 506(a)'s second sentence undercuts the majority's insistence that it has little meaning.

On the other hand, the House report's concern that secured creditors not receive "extraneous, non-financial" leverage, *see* H.R. REP. No. 595, 95th Cong., 2d Sess. 124 (1978) ("H.R. REP. No. 595"), *reprinted in* 1978

U.S.C.C.A.N. 5963, 6085, is not particularly enlightening. Under older law, some courts allowed secured creditors to refuse to participate in chapter 13 reorganizations, giving them enormous leverage: No matter how little the collateral was worth, a secured creditor could demand repayment of *the original purchase price* or refuse to participate in the plan. As the report explains, "a few misguided decisions under current law [held that] a secured creditor with a $2000 [sic] secured by household goods worth only $200 is entitled in some cases to his full $2000 claim, in preference to all unsecured creditors." *Id.*

The replacement approach deprives secured creditors of this leverage. Such a creditor cannot demand the collateral's original purchase price—only its replacement cost *in its current condition.* To borrow the House report's illustration, the replacement approach does not permit him to demand the $2000 that the debtor paid for new silverware and china; instead, he can demand only the $200 that the debtor would have to pay for a used set. The replacement approach means only that we cannot *further* deduct the hypothetical cost of selling the used goods. Thus, the replacement approach does not grant secured creditors the enormous "non-financial" leverage of which the House report complains.

The majority observes that the report implies that a creditor should be entitled only to what he would receive if he were to possess the goods. *See* maj. op. at 48. But the report also states that a creditor's claim is unsecured only "[t]o the extent that his claim . . . exceeds the value of his collateral," H.R. REP. No. 595, at 124, *reprinted in* 1978 U.S.C.C.A.N. at 6085, necessarily implying that he is secured in the full amount of "the value of his collateral." In any event, the report does not state whether hypothetical costs of sale should be subtracted from that amount. As the authors of the report apparently were focused on the threshold concern that creditors should receive only the crammed-down value of used goods, not

the original value of new ones, it is unlikely that they even considered this issue.

2.

The remainder of the legislative history is inapposite. First, redemption of property in a chapter 7 liquidation presents a different question, as the "proposed disposition or use" is a sale by the creditor to the debtor—in other words, both a sale by the creditor and possession by the debtor. Thus, assuming *arguendo* that foreclosure valuation is appropriate for redemptions, the majority's attempt to analogize liquidation sales to reorganizations, *see* maj. op. at 48-49, serves only to underscore its unwillingness to consider the primary factors relevant to determination of value—purpose and proposed disposition or use.

Second, Congress's preference for reorganizations rather than liquidations hardly entitles us to rewrite chapter 13 in order to reduce the value of security. "Reorganization is not a Holy Grail to be pursued at any length." *Timbers,* 808 F.2d at 374 (Clark, C.J., concurring). The legislative history discussing the superiority of chapter 13 emphasizes that reorganizations are better for both debtors *and* creditors, and does not distinguish secured from unsecured creditors in this respect. *See* H.R. REP. No. 595, at 118, *reprinted in* 1978 U.S.C.C.A.N. at 6079. Thus, while Congress might have a *general* preference for reorganizations, nothing in the legislative history suggests that Congress disfavors secured credit or that we should construe the statute to minimize the value of security.

In any event, the majority's concern that replacement valuation will cause debtors simply to reaffirm secured debt and enter chapter 7 is counter-intuitive. Under any method of valuation, secured debt is crammed-down from the full amount of the debt to the current value of the collateral, and even if that amount is crammed-down only slightly, the debtor still has more money with which to pay his unsecured creditors. As noted by the majority and the House report, debtors generally favor chapter 13

over chapter 7 because it inflicts less damage on their standing with the credit industry. *See* maj. op. at 50 (quoting H.R. REP. No. 595, at 118, *reprinted in* 1978 U.S.C.C.A.N. at 6079). Thus, debtors still stand to gain from choosing chapter 13 over chapter 7.

Moreover, the Fourth and Ninth Circuits adopted replacement valuation in 1992, and this circuit and the Sixth Circuit followed in 1994. Bankruptcy courts have dutifully followed our holdings, and debtors have continued to file chapter 13 reorganization plans. Simply put, there is no reason to believe that replacement valuation will be the undoing of chapter 13.

3.

The foreclosure approach finds *no* support in the portions of the legislative history that refer to "case-by-case" adjudication. The replacement approach employs a contextual analysis, valuing property according to who *actually* possesses it and what it is *actually* worth to him. The foreclosure approach employs a considerably *less* case-by-case analysis, deducting purely *hypothetical* costs of sale regardless of who possesses the property and whether or not he intends to sell it.

Recognizing this weakness, the majority claims that its rule is less rigid than the replacement approach because it permits departures based upon "equitable considerations arising from the facts of the case." Maj. op. at 55. Whatever the latter phrase might mean, it does not distinguish the foreclosure approach from the replacement one—we could adopt either approach as a starting point and then permit *ad hoc* departures. In fact, given that the replacement approach provides a more case-specific baseline, the most case-by-case approach would be *replacement* valuation with alterations for "equitable considerations." Thus, the desirability of *ad hoc* adjudi-

cation is a separate sideshow. *Cf. infra* part IV (discussing the majority's "equitable considerations" exception).[14]

III.

A.

Of course, we may reject a statute's plain meaning in rare instances where failure to do so would lead to a result that Congress could not reasonably have intended. *See Ron Pair*, 485 U.S. at 242-43. This is not such a case, however, for the plain meaning of a § 506(a) makes good, fair economic sense.

When a reorganization succeeds, it produces a surplus that must be divided between secured and unsecured

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[14] The majority observes that the legislative history does not acknowledge that replacement valuation is a break from pre-Code practice. *See* maj. op. at 47 n.26. Even assuming that the majority's factual assertion is correct, silence in the legislative history is hardly relevant. Congress worked on the Code for nearly a decade, making significant changes in the laws, including those regarding the treatment of secured creditors. *Ron Pair*, 489 U.S. at 240. As a result, "it is not appropriate or realistic to expect Congress to have explained with particularity each step it took." *Id.*

As long as the language of the statute is plain, we must accept changes from pre-Code practice without reference to the legislative history. *See id.* at 243-44. While the Court arguably departed slightly from this directive in *Dewsnup v. Timm*, 502 U.S. 410 (1992), it acknowledged that "where the language is unambiguous, silence in the legislative history cannot be controlling." *Id.* at 419-20.

In addition, the majority's discussion of the history of bankruptcy law is simply inapposite. With only limited and seldom-invoked exceptions, Congress did not authorize reorganization bankruptcies, in which a debtor forces a delayed payment plan on its creditors and the court retains jurisdiction to oversee the repayment, until the 1930's. *See Securities & Exchange Comm'n v. American Trailer Rentals Co.*, 379 U.S. 594, 603 (1966) (corporate reorganizations); 5 COLLIER ON BANKRUPTCY ¶ 1300.01 (Lawrence P. King, et al., eds., 15th ed. 1996) (consumer reorganizations). Nonetheless, the majority cites only to cases from the nineteenth century insisting that a secured creditor *actually* sell the collateral. See maj. op. at 34 n.18.

creditors. *See supra* p. 13. It is perfectly reasonable to award much of this surplus, which the majority pejoratively calls a "windfall," to secured creditors. The surplus exists only because of their collateral, and even if the replacement approach caused them to receive the entire surplus, unsecured creditors would be no worse off than if they had foreclosed immediately.

This straightforward analysis is consistent with the Bankruptcy Code's general treatment of secured creditors. The Supreme Court routinely construes the Code's plain language to provide significant protection to secured creditors,[15] and we have repeatedly protected creditors against attempts to reduce their security.[16]

In *Timbers*, for example, the Court found that the Code strikes a sensible balance: "[T]he creditor's 'interest in property' obviously means his security interest *without taking account of his right to immediate possession of the collateral on default* . . . . The phrase 'value of such creditor's interest' in § 506(a) means 'the value of the collateral.'" *Timbers*, 484 U.S. at 372 (emphasis added). In other words, a creditor's secured claim is valued according to the value of his collateral, not the limited amount that he would net in a hypothetical foreclosure. At the same time, the secured creditor is not *further* entitled to interest payments for the debtor's continued use of the collateral: After all, confirmation of the plan vests title

[15] *See, e.g., Nobelman* (interpreting § 1322(b)(2) to prohibit debtors from using § 506(a) to cram down value of home mortgages); *Ron Pair* (interpreting § 506(b) to state that over-secured creditors are entitled to interest and costs up to the amount of their extra security).

[16] *See, e.g., Dewsnup* (holding that secured creditor is entitled to any increase in the value of collateral after initial § 506(a) valuation); *Federal Savings & Loan Ins. Corp. v. D & F Constr., Inc. (In re D & F Constr., Inc.)*, 865 F.2d 673, 675 (5th Cir. 1989) (vacating confirmation of chapter 11 plan because "technical compliance with all the requirements in § 1129(b)(2) does not assure that the plan is 'fair and equitable' [to secured creditors]").

of the property in the debtor, not the creditor. *See* 11 U.S.C. § 1327(b) (1994). Therefore, the panel opinion in this case is within a well-established line of Supreme Court and Fifth Circuit precedent recognizing that a creditor's security interest is equal to the actual value of his collateral and is not subject to judicial tampering.

B.

The majority asserts that replacement valuation would give secured creditors a "bonus" by twice compensating them for loss of the right to foreclose immediately. *See* maj. op. at 38-39. This criticism misses the mark, as the question is not whether replacement or foreclosure valuation best approximates the right to foreclose immediately, but whether the Bankruptcy Code arbitrarily limits the value of a secured claim to that amount.

In addition, it is hardly apparent that the foreclosure approach fully compensates creditors for loss of their right to foreclose. As discussed above, risks unique to reorganization can cause secured creditors to fare worse in reorganizations than in liquidations or foreclosures. *See supra* p. 13.

The majority notes that secured creditors can protect themselves against the risk of bankruptcy by charging higher interest rates and varying other terms of credit. In fact, the terms of credit between debtors and creditors—both secured and unsecured—will undoubtedly adjust to compensate for *either* legal rule, replacement or foreclosure.

When creditors lend, they account for a variety of contingencies: A debtor might pay his debt in full, a default might force the creditor to repossess collateral under either state law or chapter 7, or a debtor might seek to reorganize under chapter 13. Until now, the bargain between debtor and creditor in this circuit has reflected uncertainty about the value of collateral in a

reorganization. In the future, of course, creditors' calculations will simply reflect the majority's holding.[17]

If there is any opportunity for a windfall, it occurs under the foreclosure approach. It is not hard to imagine a debtor cramming down a secured creditor's claim to wholesale value, waiting until his plan is confirmed, and then either selling the property for its full market value or destroying it for insurance proceeds. The debtor could then pocket the difference. *See* § 1327(b) (stating that confirmation vests all property of estate in debtor). If the sale or destruction occurred prior to confirmation, however, the full amount of the proceeds would belong to the creditors.

The majority correctly responds that there is no evidence in the record before us that the Rashes could net more from a sale of their truck than could ACC. In fact, ACC trumpets its ability to resell at well above wholesale. It is not, however, hard to envision an individual debtor's finding a buyer willing to pay close to full market value while a large bank would accept less in order to move one of many foreclosed vehicles, thereby reducing storage and other transaction costs. How often that scenario will actually play out is impossible to determine on the record in this case. The lesson to be learned from this hypothetical, however, is simply that foreclosure valuation understates the value of collateral.

C.

As an accounting matter, the majority contends that replacement valuation overstates the value of collateral

[17] The resulting increase in the interest rates charged by secured creditors might have adverse economic consequences, redistributing wealth from responsible debtors to bad credit risks and thereby forcing good risks out of the credit market. *See* Zywicki, *supra*, at 263-64.

by including the cost of services provided by a retailer, such as storage and marketing. *See* maj. op. at 36-37. In doing so, the majority fails to comprehend the nature of "value." As a starting point, value is a subjective concept: An item is worth different amounts to different people, depending upon a variety of factors, including one's other possessions, ability to use it, and so on. In fact, an individual generally derives *more* "value" from a good than he pays for it, because market prices do not target specific buyers. *See* PAUL A. SAMUELSON & WILLIAM D. NORDHAUS, ECONOMICS 82-84 (15th ed. 1995) (discussing disparity between price and worth). We need not determine the actual utility that a debtor derives from collateral, however, because any *particular* piece of property is worth no more to him than the cost of replacing it. Thus, an asset's value is the amount "a person in the market would be willing to pay for [it]." *Marmolejo*, 1996 WL 327636, at *6; *see also supra* note 1.

It is therefore irrelevant that retail prices include markups above the costs of production and shipping. The replacement approach looks to a debtor's replacement cost not as a reflection of value inherent in the property, but as a measurement of the value of the collateral to him. In short, it values property from the debtor's perspective.[18]

[18] Judge Easterbrook's concurrence in *Samson v. Alton Banking & Trust Co. (In re Ebbler Furniture & Appliances)*, 804 F.2d 87 (7th Cir. 1986), is consistent with this understanding of value. As he noted, "'[v]alue' is defined for a purpose." *Id.* at 91. In that chapter 7 liquidation, the court valued inventory to determine whether a secured creditor improved its position *vis-à-vis* other creditors during the 90 days preceding bankruptcy. Thus, the purpose of the valuation required the court to determine value from the creditor's perspective. *See id.* at 91-92; *cf. Smith v. Associates Commercial Corp. (In re Clark Pipe & Supply Co.)*, 893 F.2d 693, 698-99 (5th Cir. 1990) (employing foreclosure valuation for this purpose).

D.

To conclude, the majority's economic analysis does not come close to demonstrating that the plain language of § 506(a) leads to a result that Congress could not reasonably have intended. Thus, we are not at liberty to rewrite the statute.

IV.

Turning to the case-by-case rationale, the meaning of the majority's "equitable considerations" exception is murky at best. The only example provided by the majority—valuation for the purpose of determining whether unsecured claims fall below the floor of 11 U.S.C. § 109(e) (1994)—is not an equitable consideration that a court *may* take into account; instead, that example invokes only "the purpose of the valuation," a factor that § 506(a) *requires* the court to consider. If the majority means only to convert the mandatory § 506(a) factors into permissive ones, then it exception is at least understandable, albeit wrong. If it means to replace § 506(a) altogether with *ad hoc* adjudication, then it has abdicated its responsibility to declare what the law is.

Assuming that the truth is somewhere in the middle, the court has created a fine mess. Courts engage in true "case-by-case" adjudication by applying legal standards to the facts of the case before them. When valuing collateral, we must consider a variety of facts: who owns the collateral, how he intends to use or dispose of it, his ability to do so, the effect of that disposition or use on the collateral, and so on. In conducting this analysis, however, we need a legal standard to apply.

Take, for example, *Clark Pipe*. In that chapter 7 liquidation, we needed to value collateral in order to determine whether a secured creditor had improved its position *vis-à-vis* other creditors during the 90 days preceding the debtor's filing for bankruptcy. We held that because the purpose of the valuation was to determine

whether the creditor had improved its position, the value should be determined from the perspective of the creditor, not the debtor, and it was therefore necessary to deduct the creditor's hypothetical costs of sale. *Id.* at 698-99. We also found that the collateral should be valued according to its liquidation value, because the debtor was liquidating its inventory during the period in question. *Id.* at 698. In short, we determined that foreclosure valuation was appropriate in light of the purpose of the valuation and the actual use of the property, and then applied that standard to the facts of the case.

Similarly, we now need to determine how to value collateral when a debtor proposes to retain it in a chapter 13 reorganization. The majority tells us only that the legal standard is ordinarily the amount a creditor would net from a hypothetical sale of the property, but will sometimes differ. Without even an example of a true "equitable consideration," however, we are left in the dark as to when to apply that legal standard.

The majority may or may not be correct that its refusal to settle the law will encourage the settling of individual lawsuits. *See* maj. op. at 54 n.32. I am inclined to believe that "[t]he greater the uncertainty in the legal rule, the harder it is to settle pending cases," *see Ebbler*, 804 F.2d at 91 (Easterbrook, J., concurring), but either way, bringing darkness to light is hardly the job of an appellate court.

V.

In summary, I agree with the recent statement of one bankruptcy court:

> [D]uring cramdown . . ., a creditor's rights of foreclosure, sale, bidding-in and the like are not being delayed; rather they are being extinguished and replaced forever (if the plan is successfully completed) with lesser rights. For that purpose, the proper measure of value is not what the creditor would net

in a hypothetical sale, but rather the value of the collateral "in the hands of the Debtor."

In re Freudenheim, 189 B.R. 279, 280 (Bankr. W.D.N.Y. 1995). Here, the majority eloquently explains how it believes the federal bankruptcy scheme should work. That is the role of Congress, however. Adhering to the statute's plain meaning, I respectfully dissent.

APPENDIX B

[Filed Sep. 15, 1993]

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF TEXAS
BEAUMONT DIVISION

No. 1:93-CV-0078

ASSOCIATES COMMERCIAL CORPORATION

vs.

ELRAY RASH AND WIFE JEAN RASH

MEMORANDUM OPINION

Associates Commercial Corporation ("ACC") appeals the Bankruptcy Court's confirmation of the Debtors' First Amended Plan under Chapter 13. Finding no reversible error, this court affirms the decision of the Bankruptcy Court.

FACTS AND PROCEDURAL HISTORY

Elray and Jean Rash ("Debtors") filed a Voluntary Petition for Chapter 13 relief on March 18, 1992. On the same date, Debtors filed a Chapter 13 plan outlining a repayment proposal to various creditors. At that time, Debtors owed ACC $41,171.01, secured by a lien on a Kenworth truck. The Debtors represented that the secured portion of the debt totalled $28,500.00. ACC subsequently objected to the plan on the grounds that the plan was neither feasible nor proposed in good faith. More-

over, ACC argued that the secured portion of the debt amounted to approximately $41,000.00.[1]

After a hearing, the Bankruptcy Court valued the secured portion of ACC's claim of $31,875.22. This amount represented the Bankruptcy Court's determination of the wholesale value of the Kenworth Truck. Subsequently, the Debtors amended their plan, and on January 20, 1993 the Bankruptcy Court held a Confirmation Hearing. However, because ACC's attorney was in trial on a different matter, he did not attend. After denying ACC's motion for continuance, the Bankruptcy Court confirmed the Amended Plan.

ISSUES PRESENTED

ACC urges reversal on four grounds. First, ACC argues that the Bankruptcy Court erroneously valued the collateral at wholesale value, rather than retail. Second, ACC argues that the Bankruptcy Court's denial of the motion for continuance amounted to a deprivation of due process. In its third point, ACC asserts that the Bankruptcy Court erroneously concluded that the Amended Plan is feasible. Finally, in its fourth point of error, ACC asserts that the Bankruptcy Court erroneously held that the Amended Plan was proposed in good faith. This court will address each point.

DISCUSSION

In reviewing bankruptcy decisions, this court may reverse a factual finding only when it is convinced that the determination was clearly erroneous. Fed. R. Bankr. P. 8013. However, this court reviews questions of law under a *de novo* standard of review. *In re Texas Research, Inc.*, 862 F.2d 1161 (5th Cir. 1989). When a determination

[1] The value of the secured debt is relevant because to the extent the debt is secured, the creditor is guaranteed repayment under the plan. To the extent the debt is unsecured, the debt is paid pro-rata with the other unsecured debts.

presents a mixed question of law and fact, the court reviews the factual predicates under the clearly erroneous standard, and the legal conclusions are subject to *de novo* review. *In re Clark Pipe and Supply Co.*, 893 F.2d 693, 697-98 (5th Cir. 1990).

By its first point of error, ACC argues that the collateral should be valued at retail value, as opposed to wholesale value. Under the Bankruptcy Code, the court may confirm a plan only if, "with respect to each allowed secured claim provided for by the plan . . . the value, as of the effective date of the plan, of property to be distributed under the plan on account of each claim is not less than the allowed amount of such claim." 11 U.S.C. § 1325(a)(5)(B)(ii). The value of the allowed secured claim is determined by looking to 11 U.S.C. § 506(a). That section provides, "[s]uch value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property." 11 U.S.C. § 506(a).

In this case, the purpose of the valuation is to protect a secured creditor from loss by assuring that the creditor will receive as much money under the plan as the creditor would receive were it permitted to sell the collateral in a commercially reasonable manner. *See, e.g., In re Johnson*, 117 B.R. 577, 580 (Bankr. D. Idaho 1990), *In re Malody*, 102 B.R. 745, 749 (9th Cir. B.A.P. 1989). Given this purpose, it is appropriate to value the creditor's interest from the creditor's perspective. ACC is not a retail dealer in Kenworth trucks. Rather, ACC is merely the assignee of the security agreement and loan documents. Accordingly, the amount ACC would realize from a resale would likely be the wholesale value of the truck to a retail dealer.

ACC argues that the collateral should be valued at retail or replacement value. ACC notes that § 506(a) contemplates that the court take into account the proposed disposition or use of the property. Because the

debtors intend to retain possession of the truck and use it in the effectuation of their plan, ACC argues that the collateral should be valued at what the debtors would have to pay to replace the truck. In support, ACC points to dicta from *In re Mitchell*, 954 F.2d 557, (9th Cir. 1992), and *In re Malody*, 102 B.R. 745 (9th Cir. B.A.P. 1989). These cases suggest that when the debtor retains possession of the collateral, and the collateral is essential to the effectuation of the plan, the replacement cost may be an appropriate measure by which to value the secured party's interest under § 506(a). However, the debtors' continued use of the collateral in this case has no effect on the value of the security interest to ACC. The debtors are using the truck in its ordinary, contemplated manner. In light of the purpose of the valuation and the fact that ACC is merely a lienholder and not a retail dealer, the court concludes that the wholesale value should apply. The Bankruptcy Court's disposition of ACC's first point is affirmed.[2]

ACC's second argument is that the denial of its motion for continuance amounted to a deprivation of due process. ACC urges that without its attorney present at the confirmation hearing, ACC was unable to advocate its objections that the Amended Plan was neither feasible nor proposed in good faith. The Fifth Circuit recognizes the due process right of a civil litigant to be represented by retained counsel. *Potanshnick v. Port City Constr. Co.*, 609 F.2d 1101, 1117-19 (5th Cir. 1980). In some circumstances, denial of a motion for continuance can deprive a litigant of the right to counsel. *See Anderson v.*

[2] ACC argues in the alternative that the creditor's hypothetical disposition of the collateral should control. ACC asserts that because it presented evidence that it sometimes purchases collateral at ten percent less than retail value, the Bankruptcy Court should have applied this standard of valuation. This argument is flawed because ultimately, ACC will sell the collateral. Because ACC is not a retailer, it will not sell to a retail market, and retail value should not apply.

Sheppard, 856 F.2d 741, 749 (6th Cir. 1988). However, there are no mechanical tests for determining whether a denial of a motion for continuance is so arbitrary as to violate due process. *Id.*

In this case, ACC waited until the day of the scheduled confirmation hearing to file its motion. Apparently, a trial in which ACC's attorney was participating ran longer than scheduled. ACC knew of this potential conflict long in advance of the time it actually made its motion. ACC's motion for continuance did not specify how much additional time was requested. Moreover, the record does not indicate whether ACC requested a continuance in the other matter. Under these facts, the court holds that the denial of the motion for continuance was not an abuse of discretion and was not so arbitary to violate due process.

ACC's third and fourth points of error urge that the Bankruptcy Court erroneously concluded that the Amended Plan was feasible and proposed in good faith. These are factual questions reviewed under the clearly erroneous standard. *See Public Finance Corp. v. Freeman*, 712 F.2d 219, 225 (5th Cir. 1983) (reviewing finding of whether debtors could be expected to maintain payment schedule under clearly erroneous standard); *Matter of Elmwood Development Co.*, 964 F.2d 508 (5th Cir. 1992) (reviewing finding as to debtors good faith under clearly erroneous standard).

The record supports the Bankruptcy Court's determinations. The debtors' initial projections of income and expenses indicated that $925 per month was available to contribute to the repayment plan. Subsequently, at the valuation hearing, Mr. Rash testified that he was receiving an average income of about $1200 per week leasing the truck to a freight company. The record is unclear as to the exact duration that Mr. Rash would be receiving the lease payments, although Mr. Rash stated that he hoped he would continue to receive payments in this amount.

Additionally, the record reveals that Mrs. Rash contributes to the debtors' gross income by working as a dental assistant. Considering the estimates of the debtors' expenses, the court cannot say that the debtors will be unable to meet the increased payment schedule under the Amended Plan. The Bankruptcy Court's finding was not clearly erroneous.

The record also supports the Bankruptcy Court's finding that the Amended Plan was proposed in good faith. The debtors plan to pay $1050 per month to the trustee in an attempt to satisfy their existing obligations. This is not a nominal amount that would suggest that the Amended Plan was filed in an attempt to defraud existing creditors. Likewise, there is no indication that the debtors are attemping to abuse the spirit of the Bankruptcy Code. *See Matter of Chaffin*, 816 F.2d 1070, 1073 (5th Cir. 1987) *Modified*, 836 F.2d 216 (5th Cir. 1988). As evidenced by the Voluntary Petition, there is no indication that the debtors have made serial Bankruptcy filings. ACC has offered no evidence that the Plan was not proposed in good faith.[8] In light of the entire record, this court holds that the Bankruptcy Court's determination that the Amended Plan was proposed in good faith was not clearly erroneous.

The decision of the Bankruptcy Court is AFFIRMED.

Signed this 15th day of September, 1993.

/s/ [Illegible]
United States District Judge

[8] ACC points to the fact that the Amended Plan proposes increased payments $125 above the payments outlined in the Original Plan. ACC urges that this indicates the debtors are not committing all of their available income to the Amended Plan. The court notes that repayment plans are based on the projected income and expense schedules prepared at the time of filing. There is no evidence to indicate that the debotrs did not act in good faith in projecting their income on which the Original Plan was based.

APPENDIX C

UNITED STATES COURT OF APPEALS
FIFTH CIRCUIT

No. 93-5396

IN THE MATTER OF: ELRAY RASH
and JEAN RASH,
Debtors.

ASSOCIATES COMMERCIAL CORPORATION,
v. *Appellant,*

ELRAY RASH and JEAN RASH,
Appellees.

Appeal from the United States District Court
for the Eastern District of Texas
Howell Cobb, Judge

Aug. 16, 1995

ON PETITION FOR REHEARING

Before REYNALDO G. GARZA, SMITH, and PARKER, Circuit Judges.

JERRY E. Smith, Circuit Judge:

The petition for panel rehearing is DENIED. The opinion, 31 F.3d 325 (5th Cir. 1994), is modified to

delete, as *dicta*, the last portion of part II, beginning with the incomplete paragraph that begins on 31 F.3d at 329, through the end of part II, *id.* at 331.

In their suggestion for rehearing en banc, which remains pending despite our denial of panel rehearing, the debtors assail this court's holding that retail or replacement value is to be used to value collateral that a debtor proposes to retain in a chapter 13 plan. Our opinion, *id.* at 329, speaks for itself on that issue. We wish now to note, however, that since this case was decided, the law of the various circuits has moved decidedly in the direction we have proposed.

For example, in *Metrobank v. Trimble (In re Trimble)*, 50 F.3d 530 (8th Cir.1995), the court specifically approved of our approach as follows:

> We adopt the reasoning of the Fifth Circuit in *In re Rash*, and other courts that have focused on the second sentence of section 506(a), and we now conclude that the value of Metrobank's lien interest is properly based on the *retail value* of the collateral without deduction for costs of sale. *We agree with the Fifth Circuit* that the retail valuation method is the only method that gives full effect to the entire language of § 506(a). . . . Under the wholesale valuation method, the creditor's interest would always be valued at the amount the creditor would receive upon disposition of the collateral, regardless of the purpose of the valuation or of the proposed disposition or use of the property. The wholesale method would not be affected by whether the debtor intended to release the property or intended, instead, to retain and use the property. Rather, where a debtor intends to retain and use the collateral, the purpose of the valuation is to determine the amount an undersecured creditor will be paid for the debtor's continued possession and use of the collateral, not to determine the amount such creditor would receive if it hypothetically had to repossess and sell the collateral. Such an interpretation ignores the express dictates of section 506(a).

Id. at 531-32 (emphasis added, quotation from *Rash*, 31 F.3d at 329, omitted). Thus, the Eighth Circuit agrees with our conclusion that retail value is the proper measure.

A few days after *Trimble* was decided, the First Circuit followed suit, in *Winthrop Old Farm Nurseries v. New Bedford Inst. for Sav. (In re Winthrop Old Farm Nurseries)*, 50 F.3d 72 (1st Cir.1995). Like the Eighth Circuit, the *Winthrop* court gave meaning to the second sentence of 11 U.S.C. § 506(a):

> . . . A number of courts . . ., including four Circuit Courts, have adhered to this clear expression of congressional intent and declined to value collateral that a debtor proposes to retain based on a hypothetical foreclosure sale. These courts reason that because the reorganizing debtor proposes to retain and use the collateral, it should not be valued as if it were being liquidated; rather, courts should value the collateral "in light of" the debtor's proposal to retain it and ascribe to it its going-concern or fair market value with no deduction for hypothetical costs of sale.[2]
>
> . . . .

[2] *See, e.g., In re McClurkin*, 31 F.3d 401, 405 (6th Cir. 1994) (holding that § 506(a) "does not require or permit a reduction in the creditor's secured claim to account for purely hypothetical costs of sale" of Chapter 13 debtor's residence); *Matter of Rash*, 31 F.3d 325, 329-31 (5th Cir. 1994) (holding that truck to be retained by Chapter 13 debtor must be valued at replacement cost to debtor because foreclosure value fails to account for debtor's proposed use of collateral); *Lomas Mortgage USA v. Wiese*, 980 F.2d 1279, 1284-86 (9th Cir. 1992) (holding that second sentence of § 506(a) precludes deduction of hypothetical costs of sale in valuing Chapter 13

debtor's real property to be retained by debtor), . . . *vacated on other grounds*, —— U.S. ——, 113 S.Ct. 2925, 124 L.Ed.2d 676 (1993) . . .; *In re Balbus*, 933 F.2d 246, 252 (4th Cir. 1991) (same)....

We are persuaded that [this] line of cases[1] correctly interprets the statute[,] gives meaning to both sentences of § 506(a), and enables bankruptcy courts to exercise the flexibility Congress intended. By retaining collateral, a Chapter 11 debtor is ensuring that the very event Winthrop proposes to use to value the property—a foreclosure sale—will not take place. At the same time, the debtor should not be heard to argue that, in valuing the collateral, the court should disregard the very event that, according to the debtor's plan, *will* take place—namely, the debtor's use of the collateral to generate an income stream. In ordinary circumstances the present value of the income stream would be equal to the collateral's fair market value. Under such circumstances, a court remains faithful to the dictates of § 506(a) by valuing the creditor's interest in the collateral in light of the proposed post-bankruptcy reality: no foreclosure sale and economic benefit for the debtor derived from the collateral equal to or greater than its fair market value. Our approach allows the bankruptcy court, using its informed discretion and applying historic principles of equity, to adopt in each case the valuation method that is fairest given the prevailing circumstances.

The [*contrary*] *interpretation . . . renders the second sentence of § 506(a) virtually meaningless. . . .*

[1] The court also cites, in addition to the four circuit cases (*Rash*, *McClurkin*, *Lomas*, and *Balbus*), the following: *In re Case*, 115 B.R. 666, 670 (9th Cir. BAP 1990) (holding that for chapter 12 plan confirmation purposes, hypothetical costs should not be deducted from fair market value in valuing collateral to be retained by debtor); *In re Arnette*, 156 B.R. 366, 368 (Bankr. D.Conn.1993) (holding that motor vehicle to be retained by chapter 13 debtor "should be valued at the price the debtor could get for it in a free and open market, i.e., its fair market value"); *In re Green*, 151 B.R. 501 (Bankr.D.Minn.1993) (valuing car to be retained by chapter 13 debtor at retail, rather than wholesale, value); *In re Savannah Gardens-Oaktree*, 146 B.R. 306, 310 (Bankr. S.D.Ga. 1992) (using fair market value to value apartment complex in chapter 11 adequate protection context); *In re Usry*, 106 B.R. 759, 762 (Bankr.M.D.Ga.1989) (concluding that in light of fact that chapter 11 and chapter 12 debtors planned to retain collateral to produce income, secured claim equaled amount of stipulated fair market value without deduction for hypothetical liquidation costs).

50 F.3d at 74-76 (second emphasis added).

Finally, in *Huntington Nat'l Bank v. Pees (In re McClurkin)*, 31 F.3d 401 (6th Cir. 1994), decided the week *Rash* was argued but before it was issued, the court focused, as we did in *Rash*, on the second sentence of § 506(a) in declaring that in a chapter 13 proceeding where, as here, the collateral is being retained by the debtor, no hypothetical costs of sale should be deducted, because " 'a disposition of the property is not reasonably in the offing.' " *Id.* at 404 (quoting *Brown & Co. Sec. Corp. v. Balbus (In re Balbus)*, 933 F.2d 246, 251 (4th Cir.1991)). This holding, tantamount to declaring replacement, or retail, value, to be appropriate, is cited in the passage from *Winthrop* that we have quoted above.

It is so ORDERED.

ROBERT M. PARKER, Circuit Judge, dissenting:

I respectfully dissent from the panel's denial of the petition for rehearing. I would grant the petition because I believe the original panel opinion was in error.

I

Because Associates Commercial Corp. (ACC) refused to accept Rash's Chapter 13 plan, Rash was compelled to invoke the provisions of § 1325(a)(5) of the Bankruptcy Code, which provides, in relevant part:

[T]he court shall confirm a plan if—

. . . .

(5) with respect to each allowed secured claim provided for by the plan—

(A) the holder of such claim has accepted the plan;

(B) (i) the plan provides that the holder of such claim retain the lien securing such claim; and

(ii) the value, as of the effective date of the plan, of property to be distributed under the plan on account of such claim is not less than the allowed amount of such claim; or

(C) the debtor surrenders the property securing such claim to such holder. . . .

11 U.S.C. § 1325(a)(5) (emphasis added).

Since Rash proposed to retain the truck, he had only one alternative under § 1325(a)(5)—allow ACC to retain its lien and pay ACC the present value of its secured claim. Since, under the code, the value of the secured claim is equivalent to the value of the collateral, *see* 11 U.S.C. § 506(a), the bankruptcy court had to resolve the dispute between ACC and Rash over the value of the truck. The bankruptcy court correctly held that the value of ACC's secured claim under § 506(a) was the truck's value on the wholesale market because that is all ACC, a lender not in the business of selling trucks, would be able to realize if it were forced to take possession and dispose of the truck.

II

Under § 1325(a)(5), with respect to each allowed secured claim, the debtor must either surrender the property securing the claim, i.e., the collateral, to the holder

of the claim, or allow the creditor to retain its lien on the collateral and pay the creditor, over the life of the plan, the present value of its secured claim. These two § 1325 alternatives are set forth as equivalent methods of protecting the secured creditor's interest—retention of lien and payment, or receipt, of the collateral. The purpose of determining the present value of the collateral, and thus the secured claim, is to see to it that the creditor will receive as much money under the plan, per § 1325(a)(5)(B), as the creditor would receive were it permitted to sell the collateral in a commercially reasonable manner.

Given the purpose of this valuation, it is appropriate to value the collateral from the creditor's perspective.[2] In this case, the record supports the bankruptcy court's use of wholesale value. ACC is not a retail dealer in Kenworth trucks. Rather, ACC is merely the assignee of the security agreement and loan documents. Accordingly, the amount ACC would realize from a resale would likely be the truck's wholesale value from sale to a retail dealer. ACC presented no evidence that it had the ability to dispose of the truck at its retail value.

Furthermore, assigning retail value to the collateral simply ignores the inherent risk that the creditor took when it made or obtained the loan—the risk that if the debtor defaulted, the creditor might have to repossess the collateral and sell it at less than retail value. This is a risk commercial lenders are well-equipped to address on the front end of the lending process by requiring an adequate down-payment or credit insurance. By properly evaluating the value of the collateral at the time of making or obtaining a loan, a lender is fully capable of protecting against potential loss in case of default. Thus, allowing a

[2] By using the short-hand phrases "creditor's perspective" and "debtor's perspective" I refer to the primary dispute in this case: whether the "value" of the collateral is to be determined by its value to the creditor or its value to the debtor.

secured claim in an amount greater than the creditor's potenital recovery on repossession and sale is granting the creditor more protection than that for which it bargained.

III

The panel opinion correctly focuses on 11 U.S.C. § 506(a) in determining the proper manner of valuing the collateral. This section states, in pertinent part:

> An allowed claim of a creditor secured by a lien on property in which the estate has an interest . . . is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property . . . and is an unsecured claim to the extent that the value of such creditor's interest . . . is less than the amount of such allowed claim. Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor's interest.

11 U.S.C. § 506(a). This section clearly contemplates that the courts will determine an asset's value on a case-by-case basis. *See In re Mitchell*, 954 F.2d 557 (9th Cir. 1992) (citing S.Rep. No. 989, 95th Cong., 2d Sess. 68 (1978), *reprinted in* 1978 U.S.Code Cong. & Admin. News pp. 5787, 5854).

The panel opinion holds that, read as a whole, this section requires that the collateral be valued from the debtor's perspective. The opinion first looks to the second sentence of § 506(a): "Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property. . . ." Clearly, the value is to be determined in light of the purpose of the valuation. However, to understand this, it is crucial to realize that § 506(a) valuations are performed in cases under all chapters of the Bankruptcy Code and in many different contexts within those cases. Thus, the

valuation of the creditor's interest must be informed by the specific purpose for which the valuation is made—in Rash's case, cram down under § 1325(a)(5). As discussed above, the language and purpose of § 1325(a)(5) supports valuation from the creditor's perspective.

Next, the panel opinion calls on the "disposition or use" clause in the second sentence of § 506(a) to support its holding. That clause directs us to value the creditor's interest in light of the proposed disposition or use of the collateral. However, the debtor's use of retained collateral, as in this case, should only be relevant to the extent that it affects the creditor's interest in the collateral. In other words, disposition or use is considered because of the effect it could have on the intrinsic value of the collateral, and thus on the value of the property by which the debt is secured. To the extent the property is used for its intended purpose and is properly insured and maintained, the debtor's use of the property, under a Chapter 13 plan, should not affect its valuation. The debtor's use of the property should be a consideration only to the extent that it represents an increased risk to the creditor's security.

The panel opinion also emphasizes the "estate's interest in such property" language in the first sentence of § 506(a) to support its notion that the "creditor's interest is derivatively defined by the value of the debtor's interest in the property." This language, however, does not change the primary thrust of § 506(a): an allowed claim is only a "secured claim" to the extent actually "secured" by the value of the collateral. No debt can be said to be "secured" merely by the debtor's desire to retain the collateral rather than buy a replacement. Rather, a debt can be secured, within the meaning of the Bankruptcy Code, only by the value of the collateral on the creditor's repossession and sale.

As *Collier on Bankruptcy* explains, the "estate's interest" language is designed to prompt a determination

of "whether the estate actually has an interest in the collateral," and to prompt an examination of the nature of the estate's interest in the collateral. *See* 3 Lawrence P. King, *Collier on Bankruptcy* para. 506.04, at 506-17 to -19 (15th ed. 1994). As *Collier* observes:

> The interest of the estate in the subject property may be of a nature other than an ownership interest, such as a leasehold interest. Alternatively, the debtor may not be the sole owner. In such an instance the value of the estate's interest in the subject property may be substantially different than, and may even be determined appropriately by means of a different method than, the value of the property itself.

Id. at 506-18. Thus, the key purpose of the "in the estate's interest" language is to point out that the value of the estate's interest may differ from the value of the collateral. The language is not the critical focus of the valuation question, however, for as § 506(a) clearly states, it is the "*creditor's interest* in the estate's interest in such property" that is to be valued. Simply put, the estate's interest is only relevant as a starting point—the value of a secured claim is ultimately determined by ascertaining the creditor's stake in this interest. Thus, § 506(a) clearly requires us to determine the value of the collateral from the creditor's perspective, and the panel opinion's valuation of the retained asset based on the debtor's perspective is misplaced.

This conclusion does not mean that retail value is always inappropriate. For example, a secured creditor who is also a retail dealer may be able to resell for retail value. However, this determination is necessarily fact-specific and should be made on a case-by-case basis from the creditor's perspective.

IV

As a result of the panel opinion, the secured creditor, ACC, will receive a secured claim valued at retail value,

which the panel defines as the amount that the debtor Rash would have to pay to purchase another similar truck. The net effect of the panel's holding is that ACC, a nondealer creditor, receives a windfall from Rash's bankruptcy in the form of a retail mark-up over what it would have been entitled to receive under state law upon repossession and sale of the collateral. Because I believe this is an incorrect interpretation of the Bankruptcy Code, I would grant the debtor's petition for rehearing and reconsider our previous panel opinion.

APPENDIX D

UNITED STATES COURT OF APPEALS
FIFTH CIRCUIT

No. 93-5396

IN THE MATTER OF ELRAY RASH
and JEAN RASH,
Debtors.

ASSOCIATES COMMERCIAL CORPORATION,
Appellant,

v.

ELRAY RASH and JEAN RASH,
Appellees.

Appeals from the United States District Court
Eastern District of Texas

Sept. 13, 1994

Before REYNALDO G. GARZA, SMITH and PARKER, Circuit Judges.

JERRY E. SMITH, Circuit Judge:

The Associates Commercial Corporation ("ACC") appeals the district court's confirmation of a reorganization plan under chapter 13 of the Bankruptcy Code (the "code"). Because the district court erred as a matter of law in calculating the value of ACC's secured claim under 11 U.S.C. § 506(a), we reverse.

I.

A.

On March 30, 1989, Elray and Jean E. Rash [1] purchased a commercial truck at retail value of $73,700 by entering into a sales agreement and related documents ("loan documents") with Janoe Truck Sales & Service, Inc., d/b/a Janoe Kenworth Trucks ("Janoe"). The truck served as collateral for the loan. Rash owns and operates the truck as part of his freight hauling business. Janoe assigned the loan documents to ACC, which holds a valid lien on the collateral.

Under the terms of the loan, Rash was obligated to pay to ACC $1,610.41 per month for sixty months, maintain the collateral, and keep it adequately insured. In February 1992, Rash and ACC agree to reschedule his obligation upon his agreement to pay $1,408.33 for thirty-six months.

B.

In March 1992, Rash filed a petition for bankruptcy under chapter 13. Rash recognized ACC's superior lien on the collateral. Pursuant to his chapter 13 plan, Rash proposed that ACC retain its lien and be paid $607.79 per month for fifty-eight months, beginning after confirmation, for a principal total of $28,500, plus interest at nine percent. Rash represented in the plan that the collateral would remain insured but that the proposed payment "represent[ed] payment of the value of the Collateral in full with interest over the life of the Plan," which was for five years. Rash's plan made ACC a partially unsecured creditor that Rash could treat as holding a partially unsecured claim. Rash's plan also set forth that unsecured creditors "shall receive in pro-rata amounts all amounts remaining after priority and secured debts are paid."

On May 1, 1992, ACC filed a motion for relief from stay, alleging that Rash had no equity in the collateral.

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[1] For simplicity, the Rashes are referred to simply as "Rash."

ACC subsequently filed a proof of claim in the secured amount of $41,171.01. Rash responded that the value of ACC's collateral was only $28,500 and that the remainder of ACC's claim was unsecured. ACC challenged Rash's plan as inequitable because it did not pay ACC what it could have received in a chapter 7 liquidation and infeasible because it did not conform to the requirements of chapter 13.

At a hearing in bankruptcy court, ACC's expert testified that the market value of the truck was $41,000. "Market value" was defined as "what an individual, average individual off the street" would pay for the truck, or the price that would be received from a public auction sale. Rash's expert testified that market value should be determined by the wholesale value of the truck, $31,875. He applied the wholesale value because he said that the difference between wholesale and retail value represents the margin between a dealer's costs of marketing, reconditioning, payment of sales commissions, and a dealer's profit. Both experts agreed as to the retail value of the truck; they just disagreed as ot whether the retail or wholesale value should be used.

The bankruptcy court adopted the measurement proffered by Rash's expert. In line with this value, Rash filed an amended chapter 13 plan promising to pay $31,875 in fifty-eight installments plus nine percent interest, with the remaining value of ACC's claim to be paid pro-rata as an unsecured claim. The bankruptcy court confirmed this plan, 149 B.R. 430, and the district court affirmed.

II.

Under § 1325(a)(5)(B) of the code, 11 U.S.C. § 1325(a)(5)(B), a secured creditor must receive the present value of its allowed secured claim under a chapter 13 plan of reorganization. Unless the creditor's present value is preserved, confirmation cannot occur over the creditor's objection. The allowed secured claim is determined by 11 U.S.C. § 506(a), which provides, in pertinent part:

> An allowed claim of a creditor secured by a lien on property in which the estate has an interest . . . is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property . . . and is an unsecured claim to the extent that the value of such creditor's interest . . . is less than the amount of such allowed claim. Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property. . . .

We first look to the text of the statute, construing its terms according to their plain meaning. *Patterson v. Shumate*, —— U.S. ——, ——, 112 S.Ct. 2242, 2246, 119 L.Ed.2d 519 (1992). Each term must be given effect so as to avoid rendering an part of the statute inoperative. *United States v. Nordic Village, Inc.* —— U.S. ——, ——, 112 S.Ct. 1011, 1015, 117 L.Ed.2d 181 (1992); *Reiter v. Sonotone Corp.*, 442 U.S. 330, 339, 99 S.Ct. 2326, 2331, 60 L.Ed.2d 931 (1979). If a term is ambiguous, it should be construed consistently with other terms in the statute so as to produce a symmetrical whole and avoid creating tension in the statute. *Federal Power Comm'n v. Panhandle E. Pipe Line Co.*, 337 U.S. 498, 514, 69 S.Ct. 1251, 1260, 93 L.Ed. 1499 (1949)

Cases construing § 506(a) have focused on two different clauses whose relative emphases lead to differing results. *See In re Green*, 151 B.R. 501, 502 (Bankr.D. Minn. 1993). One line of cases rests on the language of § 506(a)'s first sentence, which provides that the creditor's claim is secured to the extent of the value of its interest in the estate's interest in such property. Under this approach, the secured creditor is entitled to receive, in the chapter 13 plan, the amount it could have obtained if the collateral were foreclosed upon and sold by the creditor.

This "foreclosure approach" was followed by the bankruptcy and district courts in the current case and in *In re Mitchell*, 954 F.2d 557 (9th Cir.1992), *cert. denied*, —— U.S. ——, 113 S.Ct. 303, 121 L.Ed.2d 226 (1992). *But see Lomas Mortgage USA v. Wiese (In re Wiese)*, 980 F.2d 1279, 1286 (9th Cir.1992), *vacated on other grounds*, —— U.S. ——, 113 S.Ct. 2925, 124 L.Ed.2d 676 (1993) (suggesting that the decision in *Mitchell* contradicts the language of § 506(a) and illogically "allow[s] the debtor to keep the home but value[s] the secured portion based upon a hypothetical sale of the residence"). Because the foreclosing creditor is not a dealer in the property comprising the collateral, it could not resell the collateral at retail prices. Thus, its interest in the wholesale price it would receive by selling the property to a retailer. *Green*, 151 B.R. at 504. Under this approach, the court will also generally deduct, from the wholesale price, the costs that would be incurred in executing the resale.

A second line of cases relies upon the second sentence of § 506(a), which provides that the creditor's lien interest must be valued in light of the purpose of the valuation and the proposed disposition or use of the collateral. "Where the debtor proposes to retain and use the collateral, and the purpose of the valuation is to determine the amount that an undersecured creditor will be paid on its secured claim under the debtor's plan, the value of the creditor's lien is derived from the stream of payments that the lien secures, rather than the right to foreclose, since no liquidation of the collateral is contemplated." *Green*, 151 B.R. at 504.

Under this "replacement model," the "value of the lien should be based on the retail value of the collateral since such is the replacement value to the debtor; and the costs associated with sale of the collateral should not be deducted since no sale is contemplated." *Green*, 151 B.R. at 504. *See In re Coker*, 973 F.2d 258, 260 (4th Cir. 1992); *Brown & Co. Sec. Corp. v. Balbus (In re Balbus)*, 933 F.2d 246, 251-52 (4th Cir.1991). Proponents of the "replacement cost" approach argue that it is the only one that gives effect to the entire language of § 506(a), whereas the foreclosure approach ignores the second sentence of the statute.

We agree that the replacement cost approach is the only one that gives full effect to the language of § 506(a). Under that subsection, we must consider the "purpose of the valuation" and "the proposed disposition or use" of the property by the debtor. "If the first sentence of § 506(a) were interpreted to mean that the value must be fixed at the amount which the creditor would receive on foreclosure, then the last sentence of the statute which provides that the value should be determined in light of the purpose of the valuation and of the proposed disposition or use of the property, would be surplusage." *In re Courtright*, 57 B.R. 495, 497 (Bankr.D. Or.1986); *see also In re Bergh*, 141 B.R. 409, 419 (Bankr.D.Minn. 1992) (noting that the "key phrase in § 506(a) is '[s]uch value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property. . . .' ").

Moreover, § 506(a) instructs us to value the creditor's interest according to "the estate's interest" in the property. The "estate's interest in the property" is the ownership and possession of the vehicle by the debtor, *see Mitchell*, 954 F.2d at 561 (Noonan, J., dissenting), and thus the creditor's interest is derivatively defined by the value of the debtor's interest in the property.

If the debtor retains the property as part of a reorganization, the proper measurement of the estate's interest in the property is the "going-concern" value of the collateral to the debtor's reorganization. The value to the debtor of retaining and using the property can best be measured by what he would have to pay to purchase

another truck. *See id.* (Noonan, J., dissenting). Under § 506(a), the court must value the collateral in light of its purpose and proposed use in the reorganization. Going concern, or replacement, value accounts for the debtor's proposed use of the property, whereas foreclosure value does not. "[W]hen a debtor intends to continue use of creditor's collateral, the Debtors are acknowledging the value of the collateral to be greater than if liquidated. Therefore, creditor's secured claim is entitled to be valued to the extent of its contributions to the entire estate vis-a-vis 'going concern value' . . . ." *In re Penz,* 102 B.R. 826, 828 (Bankr.E.D.Okla.1989); *see also In re Reynolds,* 17 B.R. 489 (Bankr.N.D.Ga.1981).

The creditor has a security interest in an income stream derived from the loan. Thus, the creditor's interest is the full amount of its debt, limited only by the estate's interest in the collateral. As the court wrote in *Green:*

> It is true that the plain meaning of the first sentence of section 506(a) requires a valuation of the creditor's lien interest in the collateral. However, the fact that a lien in property gives the lienholder a right to repossess and sell the collateral does not automatically mean that the value of the lien is equal to the amount that the creditor would receive upon disposition of the collateral in satisfaction of its lien. It must be remembered that a lien is fundamentally a *security* interest which secures payment of an obligation. To value such an interest in property based solely on the amount that could be realized upon sale of the collateral ignores the value associated with the right to receive the stream of payments that the lien secures.

Green, 151 B.R. at 505 (emphasis in original).

The stream of payments in which the creditor has a security interest will be greater in nominal value than the value of the collateral alone because it includes the op-

portunity cost to ACC of being forced to continue to tie up money in a loan with Rash, rather than being able to lend this money to someone else. The loss to the creditor is not just the inability to foreclose and receive the value of the collateral, but includes the inability to foreclose and then re-lend the money to someone else. "[I]f the creditor was not forced to lend to this debtor, then it could lend those funds to a different borrower. This is the real cost of the inability to foreclose." Todd J. Zywicki, *Cramdown and the Code: Calculating Cramdown Interests Rates Under the Bankruptcy Code,* 19 T. Marshall L.J. 241, 262 (1994). "[V]aluation based on a hypothetical sale ignores the purpose of the valuation which is to determine the amount an undersecured creditor will be paid *for the debtor's continued possession and use of the collateral,* not to determine the amount such creditor would receive if it had to repossess and sell the collateral." *Green,* 151 B.R. at 505 (emphasis added).

This foregone loan would have been secured by collateral valued according to its retail value. When Rash initially borrowed the money to buy the truck, the loan amount was for the retail price of the truck, not merely the wholesale amount. Reducing the security interest to its wholesale value would allow parties to use bankruptcy to alter their substantive rights as defined outside bankruptcy. Indeed, a debtor could use bankruptcy to knock-down the secured creditor's interest to wholesale value, then turn around the resell the collateral at retail blue-book value and pocket the difference. Wherever possible, we try to preserve the terms of the parties' original bargain so that bankruptcy is not used opportunistically to renegotiate the terms of a voluntary agreement or to generate a windfall for one party or the other. *See Butner v. United States,* 440 U.S. 48, 55, 99 S.Ct. 914, 918, 59 L.Ed.2d 136 (1979).

Awarding the secured creditor only the wholesale value of the collateral would undercompensate the creditor in bankruptcy. Allowing the debtor to decrease the value

of its collateral by filing bankruptcy would lead to inefficient self-protection measures by creditors, such as requiring debtors to put more cash down at the time of purchase or charging a higher interest rate to offset the risk that the debtor will file bankruptcy and strip down the value of the creditor's security interest. Unable to distinguish between good and bad borrowers, creditors will "alter their behavior towards debtors as a *class*." Zywicki, *supra*, at 263. This will actually *harm* debtors, for, as a result, "[t]he apparent pro-debtor effects of the bankruptcy rule will be eliminated by the increased rate charged to debtors as a class." *Id.*

It has been suggested that reinstating the secured creditor's interest to its full retail value would be counterproductive, as it would offer the debtor no relief, thereby undermining the rehabilitative purposes of chapter 13. Any benefit that this would provide to debtors, however, would be pyrrhic, as any advantage gained in reorganization would be offset by increases in downpayments and interest rates at the initial time of the loan.

Moreover, while reorganization of the debtor is an important policy goal, this goal cannot be pursued by exterminating a secured creditor's property interest. "Reorganization is not a Holy Grail to be pursued at any length." *United Sav. Ass'n v. Timbers of Inwood Forest Assocs., Ltd. (In re Timbers of Inwood Forest Assocs., Ltd.)*, 808 F.2d 363, 376-77 (5th Cir.1987) (en banc) (Clark, C.J., concurring), *aff'd*, 484 U.S. 365, 108 S.Ct. 626, 98 L.Ed.2d 740 (1988). Secured creditors should not be forced to bear the burden of the debtor's reorganization. *But see United Sav. Ass'n v. Timbers of Inwood Forest Assocs., Ltd.*, 484 U.S. 365, 378-79, 108 S.Ct. 626, 634, 98 L.Ed.2d 740 (1988) (noting that even if secured creditors do not bear one kind of reorganization cost, they may still bear others).

The replacement approach is consistent with the Supreme Court's holding in *Timbers of Inwood Forest, see*

Mitchell, 954 F.2d at 562 (Noonan, J., dissenting). In construing § 362(d)(1), the Court reviewed the similar language of § 506(a), concluding that "the creditor's 'interest in property' [in § 506(a)] obviously means his security interest without taking account of his right to immediate possession of the collateral on default." 484 U.S. at 372. Thus, the interest being protected by § 506(a) "is merely a security interest, which is a right to have the collateral applied in satisfaction of a debt, not a right to immediate possession of the collateral." *Green*, 151 B.R. at 505.

Thus, retail value is the proper measurement for purposes of determining an undersecured creditor's allowed amount of a secured claim under § 506(a). Both wholesale valuation and techniques that average wholesale and retail values, *see, e.g., In re Carlan*, 157 B.R. 324 (Bankr.S.D.Tex.1993), undercompensate the secured creditor and provide an invalid windfall to the debtor.

Finally, it is argued that profit should be eliminated from calculations of the value of the creditor's lien. *See In re Miller*, 4 B.R. 392 (Bankr.S.D.Cal.1980). This is incorrect, as what is deemed "profit" is actually the opportunity cost of keeping ACC's money tied up in Rash's loan and the normal return on capital, without which the loan will not be made. *See* Zywicki, *supra*, at 261-62.

III.

The bankruptcy and district courts erred as a matter of law by using wholesale instead of retail value to calculate the secured portion of ACC's claim. Thus, we REVERSE the district court's confirmation of the plan and REMAND for recalculation of the allowed amount of ACC's secured claim for purposes of the plan.

APPENDIX E

UNITED STATES BANKRUPTCY COURT
E.D. TEXAS
BEAUMONT DIVISION

Bankruptcy No. 92-10305

In re ELRAY RASH and wife JEAN RASH,
Debtors.

Jan. 11, 1993

OPINION

DONALD R. SHARP, Bankruptcy Judge.

Comes now before this Court the Motion of Associates Commercial Corporation for Relief from Stay and the Objection of Debtors, Elray and Jean Rash to Allowance of Claim of Associates Commercial Corporation pursuant to regular setting in Beaumont, Texas. This opinion constitutes findings of fact and conclusions of law in accordance with Federal Rule of Bankruptcy Procedure 7052 and disposes of all issues before the Court.

FACTUAL BACKGROUND

Elray Rash and wife Jean Rash, hereinafter referred to as ("Debtor"), filed for relief under Chapter 13 of the Code on March 18, 1992. Debtor is the owner and operator of a 1989 T-600A Kenworth Tractor-trailer truck, hereinafter referred to as ("truck"), which is used in Debtor's business of hauling freight. The majority of Debtor's income stems directly from his ability to operate this truck.

Debtor's interest in the truck is subject to the security interest of Associates Commercial Corporation, hereinafter ("Associates"), in the amount of $41,171.01, as reflected by Associates' proof of claim. Associates claims it is fully secured. Debtor has filed an objection to Associates' claim on the basis that the value of the truck is significantly lower and therefore Associates is under-secured. In addition, Associates has filed a Motion Requesting Relief from the Automatic Stay alleging, inter alia, lack of insurance coverage, insufficient maintenance and a denial of adequate protection. The matters were consolidated for hearing.

At the regularly scheduled hearing the parties presented evidence to the Court concerning the truck's value. Associates maintains that the truck should be valued according to its retail value i.e. what the Debtor would be required to pay to replace it. Debtor disagrees, arguing that the appropriate standard of valuation should be the wholesale value of the truck i.e. what the truck is worth to a dealer. The testimony indicates that based on the industry "bluebook" of truck values the truck has a wholesale value of $31,875.00 and a retail value of $42,500. The outcome of this issue will decide how Associates' claim is treated in Debtor's plan.

The question presented to the Court by the parties is whether the appropriate standard of valuation of a vehicle in Chapter 13 is the retail or the wholesale value? The matter was taken under advisement pending further review.

DISCUSSION OF LAW

STATUTORY AUTHORITY AND LEGISLATIVE HISTORY

Statutory authority and legislative history provide very little guidance in valuation matters. The full range of a court's directives in valuation questions is contained in § 506(a) of the Code:

> An allowed claim of a creditor secured by a lien on property in which the estate has an interest, or that is subject to setoff under section 553 of this title, is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property, or to the extent of the amount subject to setoff, as the case may be, and is an unsecured claim to the extent that the value of such creditor's interest or the amount so subject to setoff is less than the amount of such allowed claim. Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor's interest.

11 U.S.C.A. § 506(a) (West 1979 and Supp. 1992). The Congressional intent in enacting § 506(a) was not to dictate how valuation was to be conducted but to leave the development of valuation standards to the discretion of the courts:

> "Value" does not necessarily contemplate forced sale or liquidation value of the collateral; nor does it always imply a full going concern value. Courts will have to determine value on a case-by-case basis, taking into account the facts of each case and the competing interests in the case.

H.R.Rep. No. 595, 95th Cong., 1st Sess. 356 (1977), U.S.Code Cong. & Admin.News 1978, pp. 5787, 6312 Armed with this discretion and basing their holdings on the express terms of § 506(a) buttressed by its legislative history, courts have succeeded in developing two major irreconcilable approaches to valuation questions.

RETAIL VALUE VS. WHOLESALE VALUE

The parties presented this case to the Court as a choice between the "bluebook" wholesale or retail value. A review of the jurisprudence indicates that the overwhelming majority of all cases which discuss the valuation of automobiles also couches the discussion in a choice between the wholesale and retail value as set out in the "bluebook" which is an accepted industry standard. While this Court recognizes the ease of administration and the simplicity of preparation engendered by the simple reference to a book of values such an approach seems to circumvent the Court's duty to determine the specific case before it. This Court has a philosophical problem with the application of an industry average to a specific case in the absence of proof that the case before it is truly the average case. In the instant case, the parties equated retail value with the value that the hypothetical reasonable customer would pay for this vehicle at the hypothetical reasonable truck dealer's location. Conversely, they equated wholesale value to the price that the hypothetical reasonable truck dealer would pay the hypothetical reasonable seller for the truck prior to placing it on his lot for resale. Although this Court is certainly not convinced that an adherence to the bluebook retail or wholesale value for automobiles, mobile homes or any other type of personalty can be equated to the value of listed stock on a major stock exchange, the realities of the situation are that the marketplace is so accustomed to using these publications as guidelines that the courts must also use them. Accordingly, the remainder of this opinion will discuss the determination of value in the context of retail vs wholesale. The primary reason for this Court's willingness to accept that designation and that procedure for analysis is the Court's perception that wholesale value most often equates to the value in the hands of the creditor after he has deducted his foreclosure and disposition costs so that it is a reasonable indication of the net proceeds he will receive upon the disposition of the reclaimed collateral. Correspondingly, the retail value approximates the price the debtor would have to pay to purchase a like vehicle on the open market.

Associates argues that Debtor should be required to pay the retail value of the truck in the context of a Chap-

ter 13 plan. Proponents justify the use of retail value for three reasons. First, retail value reflects actual replacement cost to a debtor. Second, the use of retail value in a Chapter 13 case (as opposed to a Chapter 7 case) is reflective of the increased benefit derived by a debtor's retention of the collateral. Third, adjusting the value of the property to reflect potential disposition costs incurred by the creditor is inconsistent with the debtor's retention of the property. Accordingly, in cases of retention, retail as opposed to wholesale value should be the relevant standard. However, the courts advocating the use of retail value are clearly in the minority position among courts which have considered this issue. *See In re Reynolds,* 17 B.R. 489, 493 (Bankr.N.D.Ga.1981).

For his part, Debtor urges this Court to assign a value to the truck using its wholesale value. Advocates of the use of wholesale value in the context of valuing a creditor's collateral for purpose of Chapter 13 plan payment argue that § 506(a) envisions the valuation process from the perspective of the value of the collateral to the creditor. *In re Mitchell,* 954 F.2d 557, 560 (9th Cir.1992). Unless a creditor is in the business of selling collateral of a particular type on a retail basis such creditor will most likely be required to sell the goods wholesale. Accordingly, the wholesale value reflects the maximum amount that a creditor would realize as a result of its secured claim and hence is "the value of such creditor's interest." *See* § 506(a); *Mitchell, supra*; *Johnson v. General Motors Acceptance Corp.,* 115 B.R. 515, 516 (Bankr.D.S.C.1988); *In re Malody,* 102 B.R. 745, 750 (9th Cir.BAP 1989); *In re Cook,* 38 B.R. 870, 873 (Bankr.D.Utah 1984); *Matter of Van Nort,* 9 B.R. 218, 221 (Bankr.E.D.Mich.1981); *Matter of Crockett,* 3 B.R. 365, 367 (Bankr.N.D.Ill.1980); *In re Adams,* 2 B.R. 313 (Bankr.M.D.Fla.1980) For the most part, these courts dismiss as irrelevant to this analysis, the recognition that Chapter 13 envisions the retention of the collateral.

Of course, the resort to retail or wholesale approaches to valuation is not exclusive. Some court's split the difference between retail and wholesale value as the only equitable approach to an intractable dilemma. *In re Chapman,* 135 B.R. 11, 14 (Bankr.M.D.Pa.1990); *In re Miller,* 4 B.R. 392, 393 (Bankr.S.D.Cal.1980). At least one court has held that a creditor is entitled to the value of an automobile equivalent to what that creditor would receive pursuant to a preexisting repurchase agreement with a dealer. *In re Stumbo,* 7 B.R. 939, 940 (Bankr.D.Colo.1981). However, it is also apparent that this position has been almost uniformly rejected. *In re Beranek,* 9 B.R. 864, 866 (Bankr.D.Colo.1981); *Matter of Cooper,* 7 B.R. 537, 539 (Bankr.N.D.Ga.1980); 3 *Collier on Bankruptcy,* para. 506.04 at 506-35 (15th ed. 1989). Finally, some courts, in dicta, have suggested that collateral which is income-producing or necessary to a plan's success should be given a premium value to reflect these attributes. *Mitchell* at 560; *In re Malody,* 102 B.R. 745, 749 (9th Cir.BAP 1989) (Use of automobile for production of income is merely incidental; not necessary for effective reorganization); *In re Coby,* 126 B.R. 593, 595 (D.Nev.1991) (income-producing property should be valued according to replacement cost); *In re Johnson,* 117 B.R. 577, 580-581 (Banksr.D.Idaho 1990).

After due consideration, the Court finds that the decisions embracing the use of wholesale value to be better reasoned and in accord with the Code. The Court is influenced in its decision by its belief that the proper administration of the entire bankruptcy system requires a proper classification of claims into secured and usecured status. The scheme of the Bankruptcy Code, continued from prior law, is to balance the equities of all parties involved and recognize that secured creditors, by virtue of their security, have a vested interest in the estate. Economic reality dictates that no matter what Congress or the courts decree a secured creditor will only recover the intrinsic value of the security upon its disposition

when he is forced to take the security in lieu of payment. To the extent that the collateral does not have intrinsic value which can be recognized in the marketplace, the creditor is simply unsecured and no amount of legislative or judicial fiat can change that position. Section 506(a) plainly allows a creditor secured status "to the extent of the value of such creditor's interest in the estate's interest in [specific] property." By its very terms, § 506(a) focuses on value from the creditor's perspective. How is that value determined? This question can be answered simply: By the amount the creditor will realize on the collateral's disposition.

Unless a creditor is positioned, upon repossession of a debtor's collateral, to sell the collateral at retail, the amount of money likely realizable by the creditor will reflect the collateral's wholesale value. As acknowledged in *In re Malody*, 102 B.R. 745, 749 (9th Cir.BAP 1989), assigning retail value to collateral "ignores the inherent risk which [creditor] undertook when it made these loans—the risk that if the debtors defaulted [creditor] might have to repossess the vehicles and sell them at values most likely less than their retail values." *Accord In re Claeys*, 81 B.R. 985, 992 (Bankr.D.N.D.1987) (". . . when the issue is the value of a secured creditor's interest in collateral, real or personal, one must uniformly take into account the anticipated costs of disposal.")

Should the fact that this Debtor proposes to retain the truck in Chapter 13 affect the truck's value? The Court concludes that it should not. There is a great deal of disagreement over the interpretation of the second sentence in § 506(a): "Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property . . ." A review of the jurisprudence indicates that no clear majority position has developed on this divisive issue. The intrinsic value to a prospective purchaser of specific use property [1] will remain

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[1] It is clear that further analysis might be necessary if we were dealing with property susceptible to different uses such as real

the same whether it is in the hands of a debtor or a creditor; nothing in the Bankruptcy Code can change this reality. However, the first sentence of § 506(a) focuses on quantifying the value of a creditor's interest in property. For the reasons previously stated, the value of the creditor's interest is measured by what the creditor would receive on account of such property upon disposition following repossession or foreclosure. The value of this interest is not changed by the debtor's retention of the property because from the creditor's perspective, his net result, in the event of future repossession or forclosure, will be the same.

In this case, the truck is being valued for the purposes of Associates Motion to Lift Stay and Debtor's Objection to Associates' Proof of Claim. Debtor's proposed use of the Truck is also undisputed. Debtor intends to use the truck for its intended purpose—hauling freight. The truck is not susceptible to multi-use such that should affect its value. Accordingly, there is no justification for valuing Associates' interest in the truck by any standard other than its wholesale value.

Should the value of the truck be affected by the acknowledgment that Debtor uses it to produce income? In several cases involving passenger automobiles, creditors have argued that retail value should apply since the use of the automobile is tied to debtor's employment and ability to successfully complete the plan. Without fail the courts which have considered this argument have rejected it on the grounds that the use of an automobile to transport a debtor to and from work is merely incidental to the production of income and/or alternatively that the use of an automobile is not necessary to the success of a debtor's plan. *Malody* at 749; *Johnson* at 580-581; *Cook* at 875 n. 11. This distinction has also been raised in the context

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estate used in an agricultural operation but suitable for development. That consideration is not present here and the Court is not called upon to deal with it.

of valuing real estate. *In re Coby*, 126 B.R. 593, 595-596 (D.Nev.1991). While not disagreeing with the results in these cases the Court questions the logic of this approach.

As previously stated, value is defined from the creditor's perspective: How much would the creditor realize upon repossession and disposition of the collateral which the debtor proposes to retain? Accordingly, it is not enough that the property is income-producing in the hands of the debtor, the creditor must demonstrate that the income-producing attributes of the property stem directly from an inherent characteristic of the property itself rather than just from debtor's use of the property.[2] In such a situation the income producing characteristic of the property would be recognized in a higher value the creditor could receive on disposition. In this case, the truck alone has no income producing attributes if the debtor does not act as its driver. In the hands of Associates the truck is just a truck.

Associates is in the business of financing trucks. While it is clear that from time to time Associates is required to repossess trucks on which there are loan defaults there is no evidence indicating how Associates disposes of the trucks upon repossession or foreclosure. In the absence of such evidence, in accordance with the reasons set forth in this opinion, the Court finds that Debtor has demonstrated that Associates' secured interest in the truck is reflected by its wholesale value[3] of $31,875.00.

[2] In a similar vein, the Court declines to follow the suggestion in *Mitchell* that the value of collateral should be adjusted upward if its use in the debtor's hands is particularly detrimental to its value. 954 F.2d at 560. Detrimental use is a risk factor which can be negated through the payment of a higher interest rate through the plan and/or a shortening of the plan term to comport with the collateral's useful life.

[3] All parties relying on this opinion should understand that the Court makes this finding only because it equates wholesale value with the value the creditor would receive upon disposition of the property after deducting foreclosure and disposition costs. The Court does not find the rubric of "wholesale" or "retail" value recited in an industry standard reference book to be of any intrinsic value if specific evidence shows a different set of circumstances.

Furthermore, even though Debtor does not have equity in the truck, Debtor has demonstrated the necessity of the truck for his reorganization and that such reorganization is in prospect. 11 U.S.C.A. § 362. Additionally, Associates' claim that its interest in the truck is not being adequately protected is not demonstrated by the evidence. The truck is insured and maintained. The Debtor is current in his payments to the Chapter 13 Trustee. No cause exists to lift the stay. Associates Motion to Lift the Automatic Stay is DENIED.

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No. 96-454

IN THE
Supreme Court of the United States
OCTOBER TERM, 1996

ASSOCIATION COMMERCIAL CORPORATION,
Petitioner,

v.

ELRAY RASH AND JEAN RASH,
Respondents.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

BRIEF IN OPPOSITION

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14 pp

Question Presented

The proper method of valuing the security interest of a secured creditor for purposes of determining the secured creditor's allowed secured claim vis a vis other claimants in chapter 13 wage earner payment plans.

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Opinions Below

The opinion of the United States Court of Appeals for the Fifth Circuit *en banc* is reported at 90 F.3rd 1036. It and the opinions preceding it are included in the appendix of the petitioner's petition for writ of certiorari.

Statement of the Case

Mr. Elray Rash owns and operates out of Lufkin, Texas, a Kenworth heavy truck to support himself and his wife Jean. He borrowed from the petitioner, Associates Commercial Corporation, to purchase the truck. Subsequently he and his wife filed a chapter 13 bankruptcy petition, promptly filing a proposed plan and thereafter complying with all requirements of the Bankruptcy Code, the rules and policies of the United States Bankruptcy Court for the Eastern District of Texas, and his proposed plan while awaiting confirmation and thereafter. He has never missed a payment.

In his chapter 13 plan, Mr. Rash proposed to pay about $28,000 to the Associates, an amount he believed to be equal to the fair market value of the truck. The Associates had filed a proof of claim claiming $42,500 owed and a security interest in the truck in an equal amount. So Mr. Rash objected to the Associates' proof of claim under 11 U.S.C. §502. The Associates used the same argument to file an objection to Mr. Rash's chapter 13 plan under 11 U.S.C. §1325 (a) (5) (B).

In due course, the bankruptcy court called the §502 hearing. The parties did not disagree that the Associates was owed money, the total amount of principal and interest owed, or the perfection or first priority of the Associates' security interest under the Texas Motor Vehicle Code. Mr. Rash

went forward and offered the testimony of Mr. Steven Thibodeaux. Mr. Thibodeaux was the sales manager of a large truck dealership in Beaumont, Texas. He testified that he conducted a physical inspection of the truck and that based on that inspection and his knowledge of truck values in the Beaumont area, the truck was worth $31,875. He qualified the value as "wholesale value".

On cross-examination, Mr. Thibodeaux showed his written report. He also stated that the wholesale value was approximately 25% less than retail but refused to agree that retail was in fact what the truck was worth.

The Associates then produced their witness. He had never seen the truck, had, no idea of wholesale or retail values, basing his numbers strictly on what he had just heard Mr. Thibodeaux testify to, and had no idea how well the Associates did when they repossessed and attempted then to sell repossessed trucks. He did state that it was company policy to try to resale for "retail" but could not say whether that policy was successful or how much time or money the company had to invest in the collateral to get that value.

The bankruptcy court, sitting as finder of fact, threw out the Associates' expert's testimony entirely. He then weighed the "wholesale" and "retail" numbers Mr. Thibodeaux had mentioned, and went with Mr. Thibodeaux's testimony that the $31,875 number was the proper value for the truck.

Mr. Rash then incorporated that number in his chapter 13 plan. He has since paid that amount to the Associates and has completed his plan. The Associates appealed both the §502 judgment and the court's subsequent confirmation of Mr. Rash's chapter 13 plan based on the truck value determined in the §502 proceeding. Because Mr. Rash was

not required to devote a full $42,500 to his truck payments, he was able to commit to and accomplish a distribution to other unsecured creditors. He personally did not profit from the reduction in secured payments to the Associates.

REASONS FOR DENYING THE PETITION

1. THE FACTS IN THIS CASE ARE ILL-SUITED FOR THE POLICY DETERMINATIONS PETITIONER SEEKS.

Both petitioner and amicus, Hibernia National Bank, discuss a great debate which appears to be capturing the bankruptcy bar today, though twenty years after the Code was enacted and twenty-three years after Chapter 13 plans first appeared. The debate involves a simple, common set of facts. A wage earner files a chapter 13 petition. Often that wage earner owns a home. We know that the home mortgage, because of the recourse nature of FNMA guarantees of home mortgages and the ultimate burden of the taxpayer in covering home mortgage deficiencies pursuant to that mortgage system, is exempt from impairment in the chapter 13 process. But personal property lenders have no special status and so those who have loaned on the petitioner's automobile are treated identically with all other secured creditors. Their debt is no different than the debt of any other creditor, but they possess a security interest in the collateral. So the Code requires that they be paid on confirmation date property with a present value equal to the value of their collateral. This is generally a stream of payments carrying a stated or implied rate of interest.

But this case fits that pattern poorly. Mr. Rash managed his automobiles under the plan without dispute. The Associates' collateral was not an automobile, not consumer property. It was commercial property. Mr. Rash

was not retaining the truck because he wanted transportation. He retained the truck because it was literally his livelihood. In that sense, the principles of collateral valuation then depart from those we traditionally apply to consumer property. Nowhere in the literature or in the Circuits do we find any extensive debate about how commercial equipment is to be valued.

The misfit continues. On page 5 of its amicus, Hibernia National Bank refers to the N.A.D.A. Official Used Car Guide. Most national commentators assume that when the terms "wholesale" and "retail" are used, it is in reference to that guide. But the commonly used regional report of that guide does not even report a "wholesale" value. In the case at bar, Mr. Thibodeaux used the McLean Hunters Market Report Blue Book, a totally separate and unrelated publication. If you refer to the N.A.D.A. guide published at the time of the adjudication in the case at bar, the regional guide specifically referred appraisers to the national guide wholesale value, disclaiming the retail listings as useful for appraisal purposes at all. And properly, the Fifth Circuit abandoned any legislating of reliance on any published report. Price lists come in and out of publication and change the basis for their calculations.

As a further example of how the case is misfit, the Fifth Circuit held that the security interest of the secured creditor was to be valued, with the probable net proceeds of the creditor on liquidation to be the measure of the value of the collateral. That was exactly the standard argued by the Associates at trial and in all subsequent phases of the appeal. They simply failed to prove by the introduction of any evidence what they were likely to receive when they liquidated the collateral. Remember that it is a total non-sequitur that "wholesale" equals net proceeds to the creditor on collateral disposition--creditors can and do in fact do much worse--just as it is a total non-sequitur that "retail" equals the replacement value of collateral. "Retail" is a marketing concept not a valuation concept.

And throughout the trial and in all subsequent appeals, Mr. Rash has never attempted to place a value on the Associates' security interest. His expert appraised the truck. Mr. Rash has told each appellate court thereafter that that appraisal was legitimate and that the bankruptcy court's use of that appraisal to find the fact of the truck's valuation was not clearly erroneous. And it is not.

This illustrates a fundamental problem of certiorari worthiness in this arena. These cases are extremely fact intensive and rely heavily on the quality of the records produced by the adversaries. Regardless of how much importance petitioner and amicus place on the debate, this Court will be faced with a petitioner who had the burden of proof on the sole operative fact in the adjudication and who failed to provide any testimony worthy of weight on that fact question. How can this Court treat seriously a complaint that a trial court came up with a bad fair market value number when the petitioner's own appraiser had never even seen the truck?

II. THE CIRCUIT SPLIT IS ILLUSORY AND SHALLOW.

The cases petitioner argues constitute the split need to be broken into two groups. On the one hand there is a line of cases involving the valuation of real property which holds that hypothetical costs of sale should not be deducted from the appraised value for §506 purposes. *In re Balbus*, 932 F.2d 246 (4th Cir. 1991); *In re Coker*, 973 F.2d 258 (4th Cir. 1992); *Lomas Mortgage USA v. Wiese*, 980 F.2d 1279 (9th Cir. 1992), reversed and remanded on other grounds,

Lomas Mortgage USA v. Wiese, US , 113 S.Ct. 2925, 124 L.Ed. 676 (1993), *In re McClurkin*, 31 F.3rd 401 (6th Cir. 1994); *In re Winthrop Old Farm Nurseries, Inc.*, 50 F.3rd 72 (1st Cir. 1995). Those cases don't necessarily hold that liquidation value is an inappropriate standard for determining fair market value but hold rather that once fair market value is determined, further deductions of hypothetical closing costs should not be made.

That is a far cry from holding that wholesale value is foreclosure value and that foreclosure value in and of itself includes deductions for hypothetical costs of sale. Moreover, those concepts used in the "hypothetical costs of sale" cases may well apply to real estate appraisal but are inapplicable to the appraisal of personal property.

The second set of cases deals more directly with the appropriate valuation standard to use. *In re Trimble*, 50 F.3rd 530 (8th Cir. 1995); *In re Taffi*, 96 F.3rd 1190 (9th Cir. 1996). But as the Fifth Circuit clearly points out in its *en banc* decision in the case at bar, the *Trimble* circuit relied totally on the Fifth Circuit panel opinion and its "wholesale" - "retail" distinction, which opinion was subsequently vacated. It is not possible to know how the Eighth Circuit would approach this same issue in view of the Fifth Circuit's *en banc* decision.

Taffi is in fact a "hypothetical closing cost" case. *Taffi* goes on to say that land for IRS claim purposes should not be valued at foreclosure but at fair market value, criticizing the Fifth Circuit's *en banc* decision, *Ibid.*, at 1192.

There is a series of distinctions between that holding and the case at bar. First, while the valuation process does in both cases separate allowed secured claims from allowed unsecured claims, IRS priority unsecured debt is significantly different from non-priority unsecured debt. 11 U.S.C. §507 (a) (8). In the context of a chapter 13, all IRS debt must be paid by the plan, 11 U.S.C. §1322 (a) (2), and the extent to which the payment stream allocated to the collateral, as opposed to the priority payment stream, pays the claim is largely problematic, only arising in the context of hardship discharge proceedings, See 11 U.S.C. 1328 (b).

Second, foreclosure valuation of real property is a special world and a departure from traditional fair market value appraisal of real property. But vehicles can enter the wholesale market easily. Their wholesale marketing is not a forced sale. An IRS auction of real estate is likely to bring an unrealistically depressed price. But even the IRS can get a reasonable approximation of fair market value at the vehicle auction. This is why the Ninth Circuit refuses, in *Taffi*, to discuss "high" or "low" blue book, Ibid., at 1192. For this reason, forced sale or auction valuation of real estate is not favored by appraisers, but vehicle appraisers routinely place fair market value exclusively at wholesale, disregarding retail appraisal as meaningless.

In short, the split with *Trimble* is both shallow and illusory and the split with *Taffi*, on careful analysis, is thoroughly illusory.

III. THERE ARE FUNDAMENTAL FLAWS IN PETITIONER'S LEGAL REASONING

Petitioner contends, consistent with the dissent in the *en banc* decision, that because 11 U.S. C. §506 (a) states that the valuation must be conducted in light of the proposed disposition of the property, "retail" value must be employed, citing *United States v. Nordic Village, Inc.*, 503 US 30 (1992) ("every word given operative effect"). In order that

§506 (a) carry that plain meaning, an additional phrase must be added to the statute: "...and it follows, as light follows the night, that when the debtor proposes to keep the property, the property is inherently more valuable." But the mere decision by the debtor that the debtor will retain the property cannot and does not cause the property inherently to be worth more. It is clear that the process of valuation must keep in mind the proposed disposition of the property; it is equally clear that it need not and ordinarily should not attribute dollars to that fact.

It is significant that, in the name of *Nordic Village*, petitioner insists that the equally plain language of §506 (a), that the security interest and not the fee be valued, be totally ignored. For it does follow as light follows the night that the security interest can never be worth more than the fee. And while under many circumstances an appraiser could conclude that the value of the security interest and the value of the fee are identical, the appraiser must also recognize in the valuation process that only the security interest is being appraised, not the fee. In our case debtor's appraiser in fact gave petitioner the benefit of the doubt and appraised the fee and not the security interest. A more than generous outcome.

IV. THERE ARE FUNDAMENTAL FLAWS IN THE POLICY ARGUMENTS OF AMICUS

This case has attracted a number of members of the financial community seeking to participate as amicus. In order to ensure that they are true friends of the court and not just lobbyists, counsel for Mr. Rash has offered to those seeking to participate, including this case's present amicus, a simple suggestion. If amicus contends that the Fifth Circuit *en banc* decision presents a financial challenge to the consumer automobile lending industry, support that position with proper statistical substantiation.

The argument of the lenders is ingenuously simple. The lenders will be paid more money under a "retail" valuation theory than under a "wholesale" valuation theory. But any sophisticated analysis of that argument would ask whether the increased payment duty might have the effect of depressing net recoveries by the lender. This analysis is the heart of the chapter 13 reform. In 1973 under the newly promulgated bankruptcy rules and official forms, *See* 57 *Marquette Law Review* 1 (1973), the Chandler Act bankruptcy courts began to confirm plans by wage earners seeking to pay out over time dividends to creditors substantially in excess of what the creditor might anticipate in a chapter 7. This creature was the progeny not of the debtors bar but of the creditors bar, an attempt to encourage greater repayment of debt by distressed consumers. Since then, including the codification of the chapter into the 1976 Bankruptcy Code, the system has recognized the importance of encouraging an effort to meet debt obligations by payment plans.

The "retail" lobbying effort, conducted by the automobile lending industry at both the congressional and judical level, thwarts the very purposes embodied in chapter 13. The effort is mean-spirited and punitive and not motivated by a desire to maximize voluntary repayment effort.

CONCLUSION

For these reasons, the Court should deny the Associates' petition for a writ of certiorari.

Dated December 19, 1996

Respectfully submitted,

JOHN J. DURKAY
Counsel of record
for Respondents,
Elray and Jean Rash
MEHAFFY & WEBER
P. O. BOX 16
BEAUMONT, TX 77704
(409) 835-5011

Debtor: *Elray Rash and Jean E. Rash*　　　　Case No.: ______

FILING OF PLAN

For Chapter 9, 11, 12 and 13 cases only.　[X] *Debtor's proposed plan dated 03-17-92 is attached.*

PRIOR BANKRUPTCY CASE FILED WITHIN LAST 6 YEARS

Location Where Filed	Case Number	Date Filed

PENDING BANKRUPTCY CASE FILED BY ANY SPOUSE, PARTNER, OR AFFILIATE OF THE DEBTOR

Name of Debtor	Case Number	Date
Relationship	District	Judge

REQUEST FOR RELIEF

Debtor requests relief under the U.S. Code title 11 chapter specified in this petition.

SIGNATURES

Attorney

X ______________________　Date: *March 17, 1992*

Attorney: *Robert E. Barron, P.C.*

JOINT DEBTORS

We declare under penalty of perjury that the information provided in this petition is true and correct.

X ______________________

Debtor: *Elray Rash*
Date: *March 17, 1992*

X ______________________

Joint Debtor: *Jean E. Rash*
Date: *March 17, 1992*

CORPORATE OR PARTNERSHIP DEBTOR

I declare under penalty of perjury that the information in this petition is true and correct and that the filing of this petition on behalf of the debtor has been authorized.

X ______________________

Signature of Authorized Individual
Name:
Title:
Date:

EXHIBIT "A"

[ ] *Exhibit "A" is attached and made part of this petition.*

TO BE COMPLETED BY INDIVIDUAL CHAPTER 7 DEBTOR WITH PRIMARILY CONSUMER DEBTS (See P.L. 98-353 §322)

We are aware that we may proceed under chapter 7, 11, or 12, or 13 of title 11, U.S. Code, understand the relief available under such chapter, and choose to proceed under chapter 7 of such title. If we are represented by an attorney Exhibit "B" has been completed.

X ______________________　Date:

EXHIBIT "B"

I, the attorney for the debtor(s) named in the foregoing petition, declare that I have informed the debtor(s) that (he, she, or they) may proceed under chapter 7, 11, 12, or 13 of title 11, U.S. Code, and have explained the relief available under such chapter.

X ______________________　Date:

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UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF TEXAS
BEAUMONT DIVISION

[Caption Omitted]

STATEMENT PURSUANT TO RULE 2016(b)

The undersigned, pursuant to Rule 2016(b), Rules of Bankruptcy Procedure, states that:

1. The compensation paid or promised by the Debtor(s), to the undersigned, is as follows:

For legal services rendered, Debtor(s) agrees to pay	$2,500.00
Prior to the filing of this Statement, Debtor(s) has paid	$1,000.00
Balance due	$1,500.00

2. The Filing Fee *has been paid*.

3. The Services rendered or to be rendered include the following:

   (a) Analysis of the financial situation, and rendering advice and assistance to the client in determining whether to file a petition under Title 11, U.S.C.

   (b) Preparation and filing of the petition, schedules, statement of affairs and other documents required by the court.

   (c) Representation of the client at the first meeting of creditors.

4. The source of monies paid by the Debtor to the undersigned was and is, earnings, wages and compensation for services performed.

5. The undersigned has received no transfer, assignment or pledge of property from the Debtor.

6. The undersigned has not shared, or agreed to share any compensation with any other person, other than with members of the undersigned's law firm.

Dated: March 17, 1992

Respectfully submitted,

/s/ R.E.B.
ROBERT E. BARRON, P.C.
TBA No. 01820800
P.O. Box 1347
Nederland, TX 77627
Attorney for Petitioner

SCHEDULE A—REAL PROPERTY

Description and Location of Property	Nature of Debtor's Interest in Property	H W J C	Market Value of Debtor's Interest	Amount of Claim Secured
House & Lot—716 N. Austin Street, Jasper, TX 75951		J	$39,000	$15,390
½ Acre, Jasper County, TX		J	$ 500	$ 0
		Total	$39,500	

SCHEDULE B—PERSONAL PROPERTY

Description of Property	Location	H W J C	Market Value of Debtor's Interest Before Claim
1. Cash on hand. [x] NONE			
2. Checking, savings or other financial accounts, certificates of deposits or shares in banks, savings, thrift, building and loan and homestead associations, or credit unions, brokerage houses, or cooperatives. *First State Bank* *204 Lamar Street* *Jasper, TX 75951* *Account # 47-860-2*		J	$ 100
3. Security deposits with public utilities, telephone companies, landlords, and others. [x] NONE			
4. Household goods and furnishings, including audio, video, and computer equipment. *Misc.*		J	$ 1,500
5. Books; pictures and other art objects; antiques; stamp coin, record, tape, compact disc, and other collections or collectibles. [x] NONE			
6. Wearing apparel. *Misc.*		J	$ 1,000
7. Furs and jewelry. [x] NONE			
8. Firearms and sports, photographic, and other hobby equipment. [x] NONE			
9. Interests in insurance policies. [x] NONE			
10. Annuities. [x] NONE			

Description of Property	Location	H W J C	Market Value of Debtor's Interest
11. Interests in IRA, ERISA, Keogh, or other pension or profit sharing plans. *IRA Account* *ADA Retirement*		 J J	 $ 3,651 $13,000
12. Stock and interests in incorporated and unincorporated businesses. [x] NONE			
13. Interests in partnerships or joint ventures. [x] NONE			
14. Government and corporate bonds and other negotiable and non-negotiable instruments. [x] NONE			
15. Accounts receivable. [x] NONE			
16. Alimony, maintenance, support, and property settlements, to which the debtor is or may be entitled. [x] NONE			
17. Other liquidated debts owing debtor including tax refunds. [x] NONE			
18. Equitable and future interests, life estates, and rights of power exercisable for the benefit of the debtor other than those listed in Schedule of Real Property. [x] NONE			
19. Contingent and non-contingent interests in estate of a decedent, death benefit plan, life insurance policy, or trust. [x] NONE			
20. Other contingent and unliquidated claims of every nature, including tax refunds, counter claims of the debtor, and the rights to setoff claims. [x] NONE			

Description of Property	Location	H W J C	Market Value of Debtor's Interest

21. Patents, copyrights, and other intellectual property.

[x] NONE

22. Licenses, franchises, and other general intangibles.

[x] NONE

23. Automobiles, trucks, trailers, and other vehicles and accessories.

1985 Lufkin Flat Bed Trailer		J	$ 2,400
1987 Buick Regal LE		J	$ 2,750
1988 Dodge Ram 50 Pickup		J	$ 3,425
1989 Kenworth Tractor		J	$28,500

24. Boats, motors, and accessories.

[x] NONE

25. Aircraft and accessories.

[x] NONE

26. Office equipment, furnishings, and supplies.

[x] NONE

27. Machinery, fixtures, equipment, and supplies.

[x] NONE

28. Inventory.

[x] NONE

29. Animals.

[x] NONE

30. Crops—growing or harvested.

[x] NONE

31. Farming equipment and implements.

[x] NONE

32. Farm supplies, chemicals, and feed.

[x] NONE

33. Other personal property of any kind not already listed.

[x] NONE

Total **$56,326**

SCHEDULE C—JOINT PROPERTY CLAIMED EXEMPT

Debtor elects the exemptions to which debtor is entitled under:

[x] 11 USC 522(b)(2): Exemptions available under applicable nonbankruptcy federal laws, and state or local laws.

Description of Property	Specify Law Providing Each Exemption	Value of Claimed Exemption	Current Value of Property w/o Deducting Exemption
Real Property			
House & Lot—716 N. Austin Street, Jasper, TX 75951			$ 39,000
	Texas Prop. Code Ann. S41.001(a)(1)	$ 23,610	
Household goods and furnishings			
Misc.			$ 1,500
	Texas Prop. Code Ann. S42.002(a)(1)	$ 1,500	
Wearing apparel			
Misc.			$ 1,000
	Texas Prop. Code Ann. S42.002(a)(5)	$ 1,000	
Interests in pension or profit sharing plans			
IRA Account			$ 3,651
	Texas Prop. Code Ann. S42.0021	$ 3,651	
ADA Retirement			$ 18,000
	Texas Prop. Code Ann. S42.0021	$18,000	
Automobiles, trucks, trailers, etc, and accessories			
1987 Buick Regal LE			$ 2,750
	Texas Prop. Code Ann. S42.002(a)(9)	$ 1	
1988 Dodge Ram 50 Pickup			$ 3,425
	Texas Prop. Code Ann. S42.002(a)(9)	$ 1	
1989 Kenworth Tractor			$ 28,500
	Texas Prop. Code Ann. S42.002(a)(9)	$ 1	

Schedule C—page 1 of —

SCHEDULE D—CREDITORS HOLDING SECURED CLAIMS

Creditor Name and Address	Date Nature of Lien, Description & Value	Claim Amount and Special Notes *	Unsecured Portion
1. Account No. Associates Commercial Corp. P.O. Box 17230 San Antonio, TX 78217-0230	1989 Loan 1989 Kenworth Tractor Value: $ 28,500.00	$ 40,500.00	$ 12,000.00 * Joint Debt
2. Account No. Chrysler Credit 14590 Heathrow First Pkwy. Houston, TX 77032	1989 Auto 1988 Dodge Ram 50 Pickup Value: $ 3,425.00	$ 4,250.00	$ 825.00 * Joint Debt
3. Account No. Community Bank P. O. Box 2236 Jasper, TX 75951	1982 Mortgage House & Lot—716 N. Austin Street Jasper, TX 75951 Value: $ 39,000.00	$ 15,390.00	$ 0.00 * Joint Debt
4. Account No. First National Bank of Jasper 801 Houston Street Jasper, TX 75951	Auto 1985 Lufkin Flat Bed Trailer Value: $ 2,400.00	$ 5,678.00	$ 3,278.00 * Joint Debt
5. Account No. GMAC P. O. Box 90600 Houston, TX 77290	1988 Auto 1987 Buick Regal LE Value: $ 2,750.00	$ 2,750.00	$ 0.00 * Joint Debt

No continuation sheets attached

Subtotal: $ 68,568.00
Total: $ 68,568.00

SCHEDULE E—CREDITORS HOLDING UNSECURED PRIORITY CLAIMS

[ ] Debtor has no creditors holding unsecured priority claim to report on this schedule E.

TYPES OF PRIORITY

[ ] **Extensions of credit in an involuntary case**

Claims arising in the ordinary course of the debtor's business or financial affairs after the commencement of the case but before the earlier of the appointment of a trustee or the order for relief. 11 U.S.C. S507 (a)(2).

[ ] **Wages, salaries, and commissions**

Wages, salaries, and commissions, including vacation, severance, and sick leave pay owing to employees, up to a maximum of $2000 per employee, earned within 90 days immediately preceding the filing of the original petition, or the cessation of business, whichever occurred first, to the extent provided in 11 U.S.C. S507(a)(3).

[ ] **Contributions to employee benefit plans**

Money owed to employee benefit plans for services rendered within 180 days immediately preceding the filing of the original petition, or the cessation of business, whichever occurred first, to the extent provided in 11 U.S.C. S507(a)(4).

[ ] **Certain farmers and fishermen**

Claims of certain farmers and fishermen, up to a maximum of $2000 per farmer or fisherman, against the debtor, as provided in 11 U.S.C. S507(a)(5).

[ ] **Deposits by individuals**

Claims of individual up to a maximum of $900 for deposits for the purchase, lease, or rental of property or services for personal, family, or household use, that were not delivered or provided. 11 U.S.C. S507(a)(6).

[X] **Taxes and Other Certain Debts Owed to Governmental Units**

Taxes, customs duties, and penalties owing to federal, state, and local government units as set forth in 11 U.S.C. S507(a)(7).

SCHEDULE E—CREDITORS HOLDING UNSECURED PRIORITY CLAIMS

PRIORITY TYPE: Taxes and Certain Other debts Owed to Governmental Units

Creditor Name and Address	Claim Date and Consideration	Claim Amount and Special Notes *	Amount With Priority
1. Account No. IRS Austin, TX 73301	1991 1040	$ 2,745.00	$ 2,745.00 * Joint Debt
		Subtotal:	$ 2,745.00
		Total:	$ 2,745.00

SCHEDULE F—CREDITORS HOLDING UNSECURED NONPRIORITY CLAIMS

Creditor Name and Address	Date Claim was Incurred Consideration for Claim	Claim Amount and Notes*
1. Account No. Bealls P. O. Box 590 Jacksonville, TX 75766-0590	1992 Credit card purchases	$ 89.00 * Joint Debt
2. Account No. Bridgestone P. O. Box 81315 Cleveland, OH 4481	1990 Credit card purchases	$ 1,207.00 * Joint Debt
3. Account No. Choice—Visa P. O. Box 6700 The Lakes, NV 88901-6700	Credit card purchases	$ 355.00 * Joint Debt
4. Citi Bank Master Card P. O. Box 6001 The Lakes, NV 88901-6001	Credit card purchases	$ 922.00 * Joint Debt
5. Account No. Discover P. O. Box 9771 Sandy, NJ 84091-5011	Credit card purchases	$ 1,031.00 * Joint Debt
6. Account No. Exxon P. O. Box 4294 Houston, TX 77097-0025	1992 Credit card purchases	$ 149.00 * Joint Debt
7. Account No. First National Bank P. O. Box 700 Jasper, TX 75951	10-91 Signature Loan	$ 2,000.00 * Joint Debt
8. Account No. Goodyear P. O. Box 5032 Sioux Falls, SD 57117-5032	Credit card purchases	$ 1,623.00 * Joint Debt
	Subtotal:	$ 7,376.00

SCHEDULE F—CREDITORS HOLDING UNSECURED NONPRIORITY CLAIMS
(Continuation Sheet)

Creditor Name and Address	Date Claim was Incurred Consideration for Claim	Claim Amount and Notes*
9. Account No. Montgomery Ward P. O. Box 535001 Dallas, TX 75353	1990 Credit card purchases	$ 1,061.00 * Joint Debt
10. Account No. Sears Roebuck & Co. # 8636 P. O. Box 29600 New Orleans, LA 70189	Credit card purchases	$ 668.00 * Joint Debt
11. Account No. Texaco P. O. Box 2000 Bellaire, TX 77402-2000	1991 Credit card purchases	$ 424.00 * Joint Debt
12. Account No. Texas Commerce Bank—Visa P. O. Box 15128 Wilmington, DE 19884-0001	Credit card purchases	$ 172.00 * Joint Debt
13. Account No. The Home Depot P. O. Box 9771 Macon, GA 31297-9771	1992 Credit card purchases	$ 110.00 * Joint Debt
14. Account No. USAA Mastercard—Visa P. O. Box 98390 Louisville, KY 40298-8390	1990 Credit card purchases	$ 3,012.00 * Joint Debt

Subtotal: $ 5,447.00
Total: $ 12,822.00

SCHEDULE G—EXECUTORY CONTRACTS AND UNEXPIRED LEASES

Name and Address of Other Parties to Instrument	Notes of Contract or Lease and Debtor's Interest

[X] No executory contracts or unexpired leases.

SCHEDULE H—CODEBTORS

Name and Address of Codebtor	Name and Address of Creditor
[X] Debtor has no codebtors.	

SCHEDULE I—CURRENT INCOME OF INDIVIDUAL DEBTOR(S)

DEBTOR'S MARITAL STATUS: ***Married***

DEPENDENTS OF DEBTOR AND SPOUSE:

NAME	AGE	RELATIONSHIP
Martin L. Rash	22	Son

EMPLOYMENT:

	DEBTOR	SPOUSE
Occupation:	Truck Driver	Dental Assistant
Name of Employer:	Selfemployed	Dr. James R. Perkins
How Long Employed:		17 Years
Employer Address:	716 N. Austin Street Jasper, TX 75951	140 W. Milam Street Jasper, TX 75951

INCOME:

	DEBTOR	SPOUSE
Curent monthly gross wages, salary, and commissions	$ 0.00	$ 770.00
Estimated monthly overtime	$ 0.00	$ 0.00
SUBTOTAL	$ 0.00	$ 770.00
LESS PAYROLL DEDUCTIONS		
a. Payroll taxes and sociay security	$ 0.00	$ 130.00
b. Insurance	$ 0.00	$ 0.00
c. Union dues	$ 0.00	$ 0.00
d. Other:	$ 0.00	$ 0.00
SUBTOTAL OF PAYROLL DEDUCTIONS	$ 0.00	$ 130.00
TOTAL NET MONTHLY TAKE HOME PAY	$ 0.00	$ 640.00

	Debtor	Spouse
Regular income from operation of business or profession or farm (attach detailed statement)	$ 3,725.00	$ 0.00
Income from real property	$ 0.00	$ 0.00
Interest and dividends	$ 0.00	$ 0.00
Alimony, maintenance or support payments payable to the debtor for the debtor's use or that of dependents listed above.	$ 0.00	$ 0.00
Social security or other government assistance	$ 0.00	$ 0.00
Pension or retirement income	$ 0.00	$ 0.00
Other monthly income	$ 0.00	$ 0.00
TOTAL MONTHLY INCOME	$ 3,725.00	$ 640.00
TOTAL COMBINED MONTHLY INCOME	$ 4,365.00	

Describe any increase or decrease of more than 10% in any of the above categories anticipated to occur within the year following the filing of this document:

NONE

SCHEDULE J—CURRENT EXPENDITURES OF INDIVIDUAL DEBTOR(S)

[ ] Check this box if a joint petition is filed and debtor's spouse maintains a separate household. Complete a separate schedule of expenditures labeled "Spouse".

Rent or home mortgage payment (include lot rented for mobile home)	$ 371.00
Are real estate taxes included? Yes x No —	
Is property insurance included? Yes x No —	
Utilities: Electricity and heating fuel	$ 245.00
Water and sewer	$ 20.00
Telephone	$ 225.00
Other	$ 0.00
Home maintenance (repairs and upkeep)	$ 0.00
Food	$ 200.00
Clothing	$ 100.00
Laundry and Dry cleaning	$ 20.00
Medical and Dental expenses	$ 150.00
Transportation (not including car payments)	$ 175.00
Recreation, clubs, and entertainment, newspaper, magazines, etc.	$ 65.00
Charitable contributions	$ 50.00
Insurance (not deducted from wages or included in home mortgage payments)	
Homeowner's or renter's	$ 0.00
Life	$ 38.00
Health	$ 219.00
Auto	$ 125.00
Other Truck, Bobtail, Trailer Insurance	$ 233.00
Taxes (not deducted from wages or included in home mortgages)	
Internal Revenue Service	$ 609.00
Installment payments: (Do not list payments to be included in the plan)	
Auto	$ 195.00
Other	$ 0.00

Alimony, maintenance, and support paid to others	$	0.00
Payments for support of additional dependents not living at your home	$	0.00
Regular expenses from operation of business, profession, or farm (attach detailed statement)	$	0.00
Other Road Expenses	$	400.00
TOTAL MONTHLY EXPENSES (Report also on Summary of Schedules)	$	3,440.00

FOR CHAPTER 12 AND 13 DEBTORS ONLY

A. Total projected monthly income	$	4,365.00
B. Total projected monthly expenses	$	3,440.00
C. Excess income (A minus B)	$	925.00
D. Total amount to be paid into plan Monthly	$	925.00

Schedule J—Curent Expenditures Page 1 of —

UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF TEXAS
BEAUMONT TEXAS

[Caption Omitted]

SUMMARY OF SCHEDULES

Name of Schedule	Attached (Yes/No)	No. of Sheets	Amounts Scheduled Assets	Liabilities	Other
A—Real Property	Yes	1	$ 39,500.00		
B—Personal Property	Yes	3	$ 56,326.00		
C—Property Claimed As Exempt	Yes	1			
D—Creditor Holding Secured Claims	Yes	1		$ 68,568.00	
E—Creditors Holding Unsecured Priority Claims	Yes	2		$ 2,745.00	
F—Creditors Holding Unsecured Nonpriority Claims	Yes	2		$ 12,823.00	
G—Executory Contracts and Unexpired Leases	Yes	1			
H—Codebtors	Yes	1			
I—Curent Income of Individual Debtor(s)	Yes	1			$ 4,365.00

Name of Schedule	Attached (Yes/No)	No. of Sheets	Amounts Scheduled Assets	Liabilities	Other
J—Current Expenditures of Individual Debtor(s)	Yes	1			$ 8,440.00

Total Number of sheets in All Schedules > 14

Total Assets > $ 95,826.00

Total Liabilities > $ 84,136.00

DECLARATION UNDER PENALTY OF PERJURY BY INDIVIDUAL DEBTOR

I declare under penalty of perjury that I have read the foregoing summary and schedules, consisting of 15 sheets, and that they are true and correct to the best of my knowledge, information, and belief.

Date *March 17, 1992*

Signature /s/ Elray Rash
Elray Rash, Debtor

Date *March 17, 1992*

Signature /s/ Jean Rash
Jean E. Rash, Joint Debtor

Penalty for making a false statement or concealing property. Fine of up to $500,000 or imprisonment for up to 5 years or both. 18 U.S.C. SS 152 and 3571.

UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF TEXAS
BEAUMONT DIVISION

[Caption Omitted]

STATEMENT OF FINANCIAL AFFAIRS

1. Income from Employment or Operation of Business.

State the gross amount of income the debtor has received from employment, trade, or profession, or from operation of the debtor's business from the beginning of this calendar year to the date this case was commenced. State also the gross amounts received during the two years immediately preceding this case calendar year.

Income, year to date:

Last year: *1991 $56,302.00—Husband*
$9,860.00—Wife

Year before: *1990 $57,663.00—Husband*
$9,717.00—Wife

Source(s): *Wages*

2. Income other than from Employment or Operation of Business.

State the amount of income received by the debtor other than from employment, trade, profession, or operation of the debtor's business during the two years immediately preceding the commencement of this case.

[X] None

3. Payments to Creditors.

a. List all payments on loans, installments purchases of goods or services, and other debts, aggregating more than $600 to any creditor, made within 90 days immediately preceding the commencement of this case.

[X] None

b. List all payments made within one year immediately preceding the commencement of this case to or for the benefit of creditors who are or were insiders.

[X] None

4. Suits, Executions, Garnishments and Attachments.

a. List all suits to which the debtor is or was a party within one year immediately preceding the filing of this bankruptcy case.

[X] None

b. Describe all property that has been attached, garnished or seized under any legal or equitable process within one year immediately preceding the commencement of this case.

[X] None

5. Repossessions, Foreclosures and Returns.

List all property that has been repossessed by a creditor, sold at a foreclosure sale, transferred through a deed in lieu of foreclosure or returned to the seller, within one year immediately preceding the commencement of this case.

[X] None

6. Assignments and Receiver.

a. Describe any assignment of property for the benefit of creditors made within 120 days immedately preceding the commencement of this case.

[X] None

b. List all property which has been in the hands of a custodian, receiver, or court-appointed official within one year immediately preceding the commencement of this case.

[X] None

7. *Gifts.*

List all gifts or charitable contributions made within one year immediately preceding the commencement of this case except ordinary and usual gifts to family members aggregating less than $200 in value per individual family member and charitable contributions aggregating less than $100 per recipient.

[X] None

8. *Losses.*

List all losses from fire, theft, other casualty or gambling within one year immediately preceding the commencement of this case or since the commencement of this case.

[X] None

9. *Payments Related to Debt Counseling or Bankruptcy.*

List all payments made or property transferred by or on behalf of the debtor to any persons, including attorneys, for consultation concerning debt consolidation, relief under the bankruptcy law or preparation of a petition in bankruptcy within one year immediately preceding the commencement of this case.

Payee:	Robert E. Barron, P.C.
Address:	TBA No. 01820800
	P. O. Box 1347
	Nederland, TX 77627
Date of payment:	March 17, 1992
Payor:	Elray Rash
Payment/Value:	$1,000.00

10. *Other Transfers.*

List all other property, other than property transferred in the ordinary course of the business or financial affairs of the debtor, transferred either absolutely or as a security within one year immediately preceding the commencement of this case.

[X] None

11. *Closed Financial Accounts.*

List all financial accounts and instruments held in the name of the debtor or for the benefit of the debtor which were closed, sold, or otherwise transferred within one year immediately preceding the commencement of this case. Include checking, savings, or other financial accounts, certificates of deposit, or other instruments; shares and share accounts held in banks, credit unions, pension funds, cooperatives, associations, brokerage houses and other financial institutions.

Institution:	*First National Bank of Jasper*
Address:	*301 Houston Street, Jasper, TX 75951*
Type of account:	
Account #:	*065-359*
Final balance:	*$-0-*
Date of closing:	
Institution:	*First National Bank of Jasper*
Address:	*301 Houston Street, Jasper, TX 75951*
Type of account:	
Account #:	*519-884*
Final balance:	*$-0-*
Date of closing:	

12. *Safe Deposit Boxes.*

List each safe deposit or other box or depository in which the debtor has or had securities, cash, or other valuables within one year immediately preceding the commencement of this case.

Institution: *First National Bank of Jasper*
Address: *301 Houston Street, Jasper, TX 75951*
Person with access: *Debtors*
Address: *716 N. Austin Street, Jasper TX 75951*
Contents: *Wills, Living Wills and Deed to Home*
Surrender date: *Closed*

13. Setoffs.

List all setoffs made by any creditor, including a bank, against a debt or deposit of the debtor within 90 days preceding the commencement of this case.

[X] None

14. Property held for Another Person.

List all property owned by another person that the debtor holds or controls.

[X] None

15. Prior Address of Debtor.

If the debtor has moved within the two years immediately preceding the commencement of this case, list all premises which the debtor occupied during that period and vacated prior to the commencement of this case.

[X] None

16. Nature, Location and Name of Business.

a. If the debtor is an individual, list the names and addresses of all businesses in which the debtor was an officer, director, partner, or managing executive of a corporation, partnership, sole proprietorship, or was self-employed professional within the two years immediately preceding the commencement of this case, or in which the debtor owned 5 percent or more of the voting or equity securities

within the two years immediately preceding the commencement of this case.

b. If the debtor is a partnership, list the names and addresses of all businesses in which the debtor was a partner or owned 5 percent or more of the voting securities, within two years immediately preceding the commencement of this case.

c. If the debtor is a corporation, list the names and addresses of all businesses in which the debtor was a partner or owned 5 percent or more of the voting securities within two years immediately preceding the commencement of this case.

Debtor is: Individual/Joint.
Business: *Elray Rash*
Address: *716 N. Austin Street, Jasper TX 75951*

Nature of business: *Trucking*
Date of operation: *October 23, 1991 to February 14, 1992*

17. Books, records and financial statements.

a. List all bookkeepers and accountants who within the six years immediately preceding the filing of this bankruptcy case kept or supervised keeping of books of account and records of the debtor.

[X] None

b. List all firms or individuals who within the two years immediately preceding the filing of this bankruptcy case have audited the books of account and records, or prepared a financial statement of the debtor.

[X] None

c. List all firms or individuals who at the time of the commencement of this case were in possession of the books of account and records of the debtor. If any of the books of account and records are not available, explain.

Name: *Debtor*
Address:

Unavailable records:

d. List all financial institutions, creditors and other parties, including mercantile and trade agencies, to whom a financial statement was issued within two years immediately preceding the commencement of this case by the debtor.

[X] None

18. Inventories.

a. List the dates of the last two inventories taken of your property, the name of the person who supervised the taking of each inventory, and the dollar amount and basis of each inventory.

[X] None

b. List the name and addresses of the person having possession of the records of each of the two inventories reported in a., above.

[X] None

19. Current Partners, Officers, Directors and Shareholders.

a. If the debtor is a partnership, list the nature and percentage of partnership interest of each member of the partnership.

[X] None

b. If the debtor is corporation, list all officers and directors of the corporation, and each stockholder who directly or indirectly owns, controls, or holds 5 percent or more of the voting securities of the corporation.

[X] None

20. Former partners, officers, directors and shareholders.

a. If the debtor is a partnership, list each member who withdrew from the partnership within one year immediately preceding the commencement of this case.

[X] None

b. If the debtor is a corporation, list all officers, or directors whose relationship with the corporation terminated within one year immediately preceding the commencement of this case.

[X] None

21. Withdrawals from a Partnership or Distributions by a Corporation.

If the debtor is a partnership or corporation, list all withdrawals or distributions credited or given to an insider, including compensation in any form, bonuses, loans, stock redemptions, options exercised and any other prerequisite during one year immediately preceding the commencement of this case.

[X] None

DECLARATION UNDER PENALTY OF PERJURY BY INDIVIDUAL DEBTOR

I declare under penalty of perjury that I have read the answers contained in the foregoing statement of financial affairs and any attachments thereto and that they are true and correct.

Date *March 17, 1992*

Signature /s/ Elray Rash
Elray Rash, Debtor

Date *March 17, 1992*

Signature /s/ Jean Rash
Jean E. Rash, Joint Debtor

Penalty for making a false statement or concealing property. Fine of up to $500,000 or imprisonment for up to 5 years or both. 18 U.S.C. SS 152 and 3571.

IN THE UNITED STATES BANKRUPTCY COURT FOR THE EASTERN DISTRICT OF TEXAS BEAUMONT DIVISION

[Caption Omitted]

CHAPTER 13—PLAN

ELRAY RASH and JEAN E. RASH, Debtors, propose this Plan for the adjustment of their debts.

1. Debtors submit to the supervision and control of the Trustee such portion of their future earnings and income as is necessary for the consummation of this Plan.

2. Debtors shall pay in full, in deferred cash payments, all claims which are entitled to priority under Section 507 of the Bankrupty Code.

3. Beginning 30 days from the date the Chapter 13 Plan was filed, Debtors will pay to the Trustee $925.00 each month for 60 months, to be distributed in the following manner:

A. The Trustee shall be paid $92.50 each month for 60 months.

B. Debtor's attorney shall receive $750.00 for 2 months beginning April 15, 1992, until a total of $1,500.00 is paid.

C. The Internal Revenue Service shall be paid a total of $2,745.00, without interest, in the following manner: $47.33 per month for 58 months, beginning June 15, 1992.

D. Associates Commercial, which holds a first lien on Debtor's 1989 Kenworth, shall retain its lien, and be paid $607.79 for 58 months beginning June 15, 1992, for a principal total or value of $28,500.00, plus interest at 9% which amounts represent payment of the value of the collateral in full with interest over the life of the Plan.

Debtor will further keep the collateral insured during the life of the Plan. The undersecured portion of this claim, if any, shall be paid as an unsecured claim as set forth below. This creditor shall release its lien on the collateral securing the debt at such time as all payments have been made as set forth in this paragraph.

E. Chrysler Credit Corporation, which holds a first lien on Debtor's 1988 Dodge Ram 50 Pickup, shall retain its lien, and be paid $73.04 for 58 months beginning June 15, 1992, for a principal total or value of $3,425.00, plus interest at 9% which amounts represent payment of the value of the collateral in full with interest over the life of the Plan. Debtor will further keep the collateral insured during the life of the Plan. The undersecured portion of this claim, if any, shall be paid as an unsecured claim as set forth below. This creditor shall release its lien on the collateral securing the debt at such time as all payments have been made as set forth in this paragraph.

F. First National Bank of Jasper, which holds a first lien on Debtor's 1985 Lufkin flat bed trailer, shall retain its lien, and be paid $51.18 for 58 months beginning June 15, 1992, for a principal total or value of $2,400.00, plus interest at 9% which amounts represent payment of the value of the collateral in full with interest over the life of the Plan. Debtor will further keep the collateral insured during the life of the Plan. The undersecured portion of this claim, if any, shall be paid as an unsecured claim as set forth below. This creditor shall release its lien on the collateral securing the debt at such time as all payments have been made as set forth in this paragraph.

G. The unsecured creditors shall receive in pro-rata amounts all amounts remaining after priority and secured debts are paid.

4. Debtors shall pay the following secured debts outside the Plan:

Secured Creditor	***Amount***	***Collateral***
Community Bank	**$15,390.00**	**716 N. Austin Jasper, TX**
GMAC	**$2,750.00**	**1987 Buick Regal LE**

5. Debtors shall return the following collateral to the secured creditors described in full satisfaction of the debt.

NONE

6. Debtors shall void the non-purchase money security interest in exempt property under Section 522(f) U.S. Bankruptcy Code for the following creditor, and the debt shall be paid as an unsecured claim for this Plan:

NONE

7. Debtors will not incur any post-petition consumer debt except after notice to creditors and approval by the Court and the Standing Chapter 13 Trustee as specified in 11 U.S.C. 1305(c). Post-petition claims will be allowed only as specified in 11 U.S.C. 1305.

8. Upon confirmation of this Plan, the property of the estate shall revest in Debtors.

9. The filing of Debtor's Petition and the Debtor's Plan shall not be construed as a waiver of the Debtor's exemptions as claimed by them in their schedule of exemptions on file herein, as allowed by law.

DATED: March 17, 1992

/s/ Elray Rash
ELRAY RASH

/s/ Jean Rash
JEAN E. RASH

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF TEXAS
BEAUMONT DIVISION

[Caption Omitted]

MOTION FOR RELIEF FROM STAY

ASSOCIATES COMMERCIAL CORPORATION (hereinafter "ASSOCIATES") files its Motion to Modify Stay for adequate protection and for cause and respectfully represents:

1. ELRAY and JEAN E. RASH filed a petition under Chapter 13 of the Bankruptcy Code on March 18, 1992. The Debtor has continued in possession of the property and is now operating its business and managing its property.

2. The Bankruptcy Court has jurisdiction over this proceeding pursuant to 28 USC § 1334 and 11 USC § 361 and 362.

3. ASSOCIATES is the Assignee for value of a sales agreement wherein Debtor is Purchaser. A true copy of the said contract and note between seller and Debtor dated March 30, 1989 is attached hereto as Exhibit "A," and hereby incorporated by reference. ASSOCIATES is the lien holder to that one certain vehicle as listed in Exhibit "A", which is the subject of said agreement, and the lien of ASSOCIATES is reflected on the Certificate of Title of said collateral, and a copy of the Certificate of Title reflecting same is attached hereto as Exhibit "B", and hereby incorporated by reference.

4. The business of the Debtor is hauling. Such use results in rapid deterioration of the collateral if not properly maintained. The Debtor has not paid the amounts due and the Debtor in possession is believed not properly maintaining the collateral.

5. The undersigned has attempted to determine whether Debtor has obtained independent insurance in force covering the said collateral. Plaintiff has reason to suspect there is no such insurance on said collateral. The Debtor is in default under the terms of the Contract for failing to make the required payments to ASSOCIATES.

6. ASSOCIATES is the holder of a secured claim against Debtor for the sum as shown on said Exhibits and has a valid security interest in the said collateral as shown in the aforesaid Exhibits. Secured creditor does not have, and has not been offered, adequate protection for its interest in the collateral listed in Exhibit "A" and "B". Such collateral is not necessary to Debtor's effective reorganization or rehabilitation and there is no reasonable prospect for a successful reorganization within a reasonable time.

7. Debtor has no known equity in the collateral listed in said Exhibits.

8. Debtor has no reasonable prospect for payment therefor, even if it could retain said assets.

9. If ASSOCIATES is not permitted to foreclose its security lien interest therein, it will suffer irreparable injury, loss, and damage.

10. In the alternative, ASSOCIATES is entitled to an order terminating the automatic stay in addition to 11 U.S.C. § 362(d)(2), for cause, including the failure by Debtor to tender adequate protection pursuant to 11 U.S.C. § 362(d)(1); and the Court should condition any order continuing the automatic stay as necessary to provide adequate protection for the Debtor's use of the Property, pursuant to 11 U.S.C. § 363(e).

11. "ANY OBJECTION OR REQUEST FOR HEARING MUST BE FILED WITH:

UNITED STATES BANKRUPTCY CLERK
211 WEST FERGUSON—4TH FLOOR
TYLER, TEXAS 75702

UNLESS A WRITTEN OBJECTION OR REQUEST FOR HEARING IS FILED WITHIN FIFTEEN (15) DAYS, INCLUSIVE OF MAILING TIME, FROM THE DATE SHOWN IN THE CERTIFICATE OF SERVICE HEREIN, THIS MOTION SHALL BE DEEMED TO BE UNOPPOSED AND THE COURT MAY ENTER AN ORDER WITHOUT A HEARING, *AT THE END OF THIRTY (30) DAYS*, REFLECTING THAT THE AUTOMATIC STAY HAS LIFTED."

The stay will terminate by operation of law at the expiration of the thirty (30) days, and an exparte order may be entered on presentation to the Court unless the Court extends the time for good cause shown. Plaintiff may enter into an agreement with the Debtor and/or Trustee whereby the stay would be continued provided certain payments are paid, insurance is maintained, and Plaintiff may seek interest, attorney fees and pre-petition arrearages.

12. Movant has conferred with opposing counsel and we cannot agree as to the disposition of this Motion.

WHEREFORE, Plaintiff prays that upon the expiration of the statutory period or after hearing of this Motion, the Stay pursuant to 11 USC § 362 be modified to direct or permit the said collateral to be delivered to ASSOCIATES or to permit it to foreclose its security lien interest herein, and grant it adequate protection such as may be provided in an order continuing the stay pending certain payments of principal, interest and insurance, and that it have such other and further relief as is just.

Respectfully submitted,

HIRSCH, GLOVER, ROBINSON & SHEINESS, P.C.

By: /s/ Ben L. Aderholt
BEN L. ADERHOLT
T/B/A 00909000
Admission ID 5877

1360 Post Oak Boulevard Suite 2300
Houston, Texas 77056
(713) 297-5824
Attorney for Plaintiff

[Attached Exhibits Omitted in Printing]

[Proof of Service of Motion to Modify Stay Omitted]

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF TEXAS
BEAUMONT DIVISION

[Caption Omitted]

OBJECTION BY SECURED CREDITOR TO CONFIRMATION OF PLAN

TO THE HONORABLE JUDGE OF SAID COURT:

Comes now ASSOCIATES COMMERCIAL CORPORATION (hereinatfer referred to as "ASSOCIATES") and would show that it is a secured creditor in this bankruptcy proceeding and files its objection of the Plan of Debtor.

1. By virtue of contracts and security agreements, the Debtor obligated itself for the purchase of certain vehicles, which contracts and obligations were assigned for valuable consideration to ASSOCIATES. The amount of the debt thereon as of date of filing was $41,171.01. Said Debtor granted to ASSOCIATES a security agreement which is noted on the Certificate of Title, a true copy of which is attached hereto as Exhibit "A", and which is incorporated herein by reference.

2. Debtor has failed to propose in good faith a feasible plan concerning ASSOCIATES, or one which is fair and equitable.

3. Confirmation of the proposed plan is likely to be followed by liquidation or additional financial reorganization because the projected income will be insufficient to meet its operating expenses and plan payments.

4. ASSOCIATES, as holder of a claim, will not receive under the plan, property equal to the allowed amount of its claim.

5. ASSOCIATES was, at filing, owed $41,171.01 upon the 1989 Kenworth Tractor Truck S/N1XKAD-29X7KS526898 and which is valued about $41,000.00 if the unit is in ordinary condition.

Debtor is consuming these depreciating assets.

6. Objection is made because Debtor has defaulted under the aforesaid contracts with ASSOCIATES as a secured creditor; the Plan does not pay the creditor what it would receive under a Chapter 7 liquidation; the plan causes irreparable damage to the said secured creditor as the asset is depreciating and there are no payments proposed upon all of the legitimate debt and the said plan is unjust and inequitable to the said secured creditor.

WHEREFORE, PREMISES CONSIDERED, secured creditor prays this Court to set this objection and the confirmation of the plan for hearing and permit the secured creditor to show just cause why its claim should be allowed and the Objection heard and the plan denied, and for all other relief to which the said secured creditor may show itself justly entitled.

Respectfully submitted,

HIRSCH, GLOVER, ROBINSON
& SHEINESS, P.C.

BY: Ben L. Aderholt
BEN L. ADERHOLT
TSB NO. 00909000
Admission ID 5877

1360 Post Oak Boulevard, Suite 2300
Houston, Texas 77056
(713) 297-5823
Attorneys for Movant

[Certificate of Service Omitted]

STATE OF TEXAS CERTIFICATE OF TITLE TO A MOTOR VEHICLE

DO NOT ACCEPT TITLE SHOWING ERASURE ALTERATION OR MUTILATION

THE STATE DEPARTMENT OF HIGHWAYS AND PUBLIC TRANSPORTATION CERTIFIES THAT THE APPLICANT HEREIN NAMED HAS BEEN DULY REGISTERED IN THE OFFICE OF THE DEPARTMENT AS THE LAWFUL OWNER OF THE MOTOR VEHICLE DESCRIBED BELOW.

ODOMETER READING
002267

MAKE OF VEHICLE
KENWORTH

MOTOR OR VEHICLE IDENTIFICATION NUMBER
1XKAD29X7KS526898

DIESEL

TITLE NUMBER
23212078

YEAR MODEL | BODY STYLE
1989 | TRK TR

LICENSE NUMBER | MFG CAPACITY IN TONS | WEIGHT
R29159 | 5 | 17700

DEPARTMENTAL USE ONLY
K688599

DATE TITLE ISSUED
05/10/89

ORIGINAL

PREVIOUS OWNER
JANOE KENWORTH TRUCKS SAN ANTONIO TX

OWNER OF LIEN RECORDED
ELRAY RASH
716 AUSTIN ST
JASPER, TEX 75951

DATE OF LIEN
03/31/89

LIEN HOLDER (OR OWNER IF NO LIEN)
ASSOCIATES COMMERCIAL CORP
PO BOX 17230
SAN ANTONIO, TEX 78217

This Title must be signed in ink upon receipt

SIGNATURE OF OWNER OR AGENT

1ST LIEN RELEASED ______ DATE ______ BY ______ AUTHORIZED AGENT

DATE OF LIEN ______ NAME AND ADDRESS OF 2ND LIEN HOLDER

2ND LIEN RELEASED ______ DATE ______ BY ______ AUTHORIZED AGENT

R.E. STOTZER, JR., ENGINEER - DIRECTOR

60091609

The applicant has affirmed under oath to be the owner of the above described motor vehicle, subject to the herein described lien and encumbrances and no others, and it appears upon the official records of the Department that at the date of the issuance of this certificate, said motor vehicle is subject to the liens hereinbefore enumerated.

Dian K. Neill

DIAN K. NEILL, DIRECTOR DIVISION OF MOTOR VEHICLES

BEST AVAILABLE COPY

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF TEXAS
BEAUMONT DIVISION

[Caption Omitted]

June 16, 1992

TRANSCRIPT OF HEARING ON (1) DEBTOR'S OBJECTION TO CLAIM OF ASSOCIATES COMMERCIAL CORPORATION, (2) MOTION BY ASSOCIATES COMMERCIAL CORPORATION TO PROHIBIT USE OF CASH COLLATERAL, (3) FINAL HEARING ON MOTION OF ASSOCIATES COMMERCIAL CORPORATION FOR RELIEF FROM AUTOMATIC STAY, BEFORE THE HONORABLE DONALD R. SHARP, UNITED STATES BANKRUPTCY JUDGE

* * * *

[2] COURTROOM DEPUTY CLERK: Elray Rash, 92-10305, Chapter 13; Debtor's Objection to Claim of Associates Commercial Corporation and Motion by Associates Commercial Corporation to Prohibit Use of Cash Collateral.

MR. BARRON: Bob Barron, for the debtor.

MR. ADERHOLT: Ben Aderholt, A-d-e-r-h-o-l-t, for Associates.

MR. BARRON: Your Honor, I would anticipate a thirty- to forty-five-minute hearing on this, if the Court desires a break.

MR. ADERHOLT: I agree with this estimation, Your Honor. I imagine we have a witness apiece, and that that's about it.

Your Honor, we also have a matter that is set on Page 9 at 1:30 which involves, in our view, approximately the

same issues. That is a 362 motion that's set at 1:30, and—

THE COURT: In this same case?

MR. BARRON: Yes, sir.

MR. ADERHOLT: Yes, sir. And I think the economy of the Court would be utilized if we could hear those together, if Mr. Barron doesn't have any objection.

MR. BARRON: I would agree with that, Your Honor.

MR. ADERHOLT: If it's all right with the Court.

THE COURT: We have two things set this morning, the [3] objection to the claim and the motion to use cash collateral.

MR. ADERHOLT: That's correct.

THE COURT: What's set at—

MR. ADERHOLT: The 362 matter.

MR. BARRON: Final hearing on motion to lift stay.

MR. ADERHOLT: Yes. It is set at 1:30 this afternoon. I do have—

THE COURT: You have no objection to hearing all of that at this time, Mr. Barron?

MR. BARRON: No, I have no objection, Your Honor.

THE COURT: Then, why don't we take a five-minute recess and we'll come back and hear your evidence on all of those matters.

(Recess from 11:10 a.m. until 11:15 a.m.)

COURT RESUMING AFTER RECESS

MR. ADERHOLT: Your Honor, in what order does the Court want to hear this?

THE COURT: Well, the objection to claim and the motion for relief from stay deal with the same property, do they not?

MR. BARRON: Yes, sir.

MR. ADERHOLT: Yes, sir.

THE COURT: So, all evidence—well, actually it all deals with the same thing, does it not?

MR. ADERHOLT: Yes, it really does, Your Honor. I [4] think the Court could hear them all at once and take all the evidence as to all three. I guess what I was asking is, who do you want to hear from as far as the evidentiary matters first?

THE COURT: Well, I think what we need to do is, Associates Commercial will assume the position of plaintiff and the debtor will assume the position of defendant, we hear all of the evidence that you have in one hearing going to all three matters, and then I'll rule on all three matters separately. Okay?

MR. BARRON: That's fine.

THE COURT: Proceed, Mr. Aderholt.

MR. ADERHOLT: Does the Court want to hear a preliminary?

THE COURT: Whatever you want. If you have something you want to tell me before you start putting on your evidence, feel free to do so. Otherwise, I'm ready.

MR. ADERHOLT: Your Honor, I think that if opposing counsel agrees with me, I believe that the amount of the debt as exhibited by our proof of claim is not in dispute. The proof of claim was filed on April 30, 1992, and the amount of that debt is $41,171.01 as of the date of filing.

THE COURT: Do you agree with that, Mr. Barron?

MR. BARRON: I would agree, Your Honor.

THE COURT: Okay.

[5] MR. ADERHOLT: I believe that the issue, therefore, will be a question of value, adequate protection, and additional collateral on the lease proceeds.

THE COURT: Okay.

MR. ADERHOLT: Your Honor, we'll call Mr. Rash.

THE COURT: Mr. Rash, come forward, sir, and be sworn, please.

(Debtor sworn)

ELRAY RASH, DEBTOR, SWORN
CALLED AS CREDITOR'S ADVERSE WITNESS
CROSS-EXAMINATION

BY MR. ADERHOLT:

Q State your name for the Court, please, sir.
A Elray Rash.
Q Mr. Rash, you're familiar with the vehicle that is the collateral of Associates Commercial Corporation, are you not?
A Yes, sir.
Q What kind of vehicle is that, sir?
A It's a 1989 T-600 Kenworth truck.
Q What year?
A '89.
Q 1989. Would you say that that vehicle—well, that's one of these 10-wheel tractors you see on the highway, isn't it?
A Yes, sir.
[6] Q It's not a pickup?
A Right.
Q Would you say that that vehicle is in ordinary good condition or in poor condition?
A It's in good condition.
Q It's in good condition?
A Yes.
Q Not mint, but just average good condition; would you say that that's fair?
A Yes, sir.
Q Now, do you have this particular unit leased to Lane Freight?
A Yes, sir, I do.
Q What are the lease payments that you get back from Lane Freight?
A I get 70 percent of the gross revenue.

Q In terms of dollars, could you help the Court in giving your best estimate of what that would be—what, do you get paid every two weeks or weekly?
A Weekly.
Q In terms of a week, what would you say are those payments that you get from Lane Freight?
A Good weeks and bad weeks combined?
Q Yes, sir.
A I would say twelve hundred.
[7] Q Twelve hundred a week?
A On an average.
Q On an average. And you've been receiving those for how long from Lake Freight?
A I think I leased back on to Lane Freight like the first of March.
Q March 1?
A Somewhere in that area. I don't have the exact date.
Q And that lease has been from March 1, continuous until today?
A Yes, sir.
Q And do you expect that to continue?
A As far as I—you know, I hope so.
Q I understand. Have you gotten an appraisal from Smart's White GMC dealership here in Beaumont?
A Yes, sir.
Q What does that value—or what does that appraisal show as the value of that vehicle if you were going to sell that vehicle to a willing buyer?
A I don't have appraisal before me, but I believe it was like thirty-one eight, $31,800. I'm not exactly sure on the numbers.
Q Well, if you're not sure, I don't want to have you guess.

MR. ADERHOLT: We'll pass the witness, Your Honor.

THE COURT: Do you wish to take your witness now?

[8] MR. BARRON: No questions, Your Honor.
THE COURT: You may step down, Mr. Rash.
MR. ADERHOLT: Your Honor, we'd call Mr. Copple.

(Witness sworn)

DIRK COPPLE, CREDITOR'S WITNESS, SWORN

DIRECT EXAMINATION

BY MR. ADERHOLT:

Q State your name to the Court, please, sir.
A Dirk Copple.
Q Mr. Copple, are you the Collections Manager for Associates Commercial Corporation?
A Yes, sir, I am.
Q Are you familiar with the kind of vehicle that you heard Mr. Rash testify to?
A Yes, sir, I am familiar with it.
Q Have you overseen and participated in the financing, purchasing, and selling of that kind of vehicle on few or many occasions?
A Many.
Q Have you done some detailed work on the book work to determine a value of the kind of vehicle that Mr. Rash was describing?
A Yes, sir, I have.
Q Do you have an opinion as to that value?
A Yes, sir, I do.
[9] Q Tell us, what all have you considered, in addition to your personal experience, in arriving at this value?
A Well, aside from my day-to-day operations, I contacted a couple of dealerships and I also used what we have as software that we use for booking out equipment, and also I've got the blue book here.
Q Now, the blue book is what, sir?
A The blue book is, basically, it's arrived from a company, not Associates, and it's used to arrive at average finance values. It's based upon day-to-day selling of the equipment.

Q Is it fair to say, then, that the industry blue book is a compilation of average sales, did you say?
A Yes, it is.
Q Tell us whether or not that is nationwide.
A Yes, it is nationwide.
Q Directing your attention to the particular vehicle, does Associates have a—Associates has a collateral interest in, what is your opinion of the current market value of that vehicle?
A It's about $41,000 if it's in average shape, as a customer.
Q You heard Mr. Rash testify that it was in average good condition, and your opinion is that that vehicle is worth what?
A $41,000.
[10] Q What do you describe as market value? What do you mean when you say market value?
A Market value is what an individual, average individual off the street, walks into a dealership, that would be a fair value for it.
Q What does the industry blue book value—what value does the industry blue book ascribe to this particular kind of vehicle right now?
A I booked it out for approximately a little over $40,000.
Q The exact figure would be what?
A $40,050.
Q $40,050?
A Yes, sir.
Q When was the last time that the debtor paid Associates on this vehicle?
A January 16 of this year.
Q Is it correct, then, that you are four months down?
A Yes, sir, that is correct. He hasn't paid in four months.
Q Are the contract payments, under Exhibit No. 1, $1,408.33?
A Yes, sir, they are.

Q So, if you marked four times that, do you get the figure of $5,613.32?
A Yes, sir, you do.
[11] Q And is that what the arrearage is on this particular vehicle?
A Yes, sir, it is.
Q Now, tell me whether or not Associates has any particular risk involved in this kind of collateral to its security position.
A Well, besides the fact that the collateral is depreciating every day, we've also got—if a customer was to file bankruptcy, for instance, we would assume that his cash flow is less than adequate, which means probably that what's going to suffer is the maintenance of the equipment, which would lead me to believe that possibly it could have a breakdown, and if it does break down, Mr. Rash would probably testify to that it's very expensive to fix the 18-wheelers, and that opens up the possibility of a mechanic's lien, which does supersede our lien, and in the event that would happen and the customer did not have the adequate funds to get it released, us, as Associates, would have to pay for that to obtain our equipment back.
Q Now, have intervening liens by mechanics happened to Associates on other occasions?
A Yes, sir. It happens frequently.
Q In your experience, what—one other question before I get to that. What is the age of this particular vehicle?
A It's an '89.
[12] Q So, that makes it what, three years old?
A Yes, sir, coming up on four.
Q Is it about time for an out-of-frame overhaul or in-frame overhaul?
A Depending on the miles it runs, but on an average it's getting pretty close.
Q And what does that cost?
A Depending on if it's maintained properly, it costs anywhere from four to ten thousand dollars, depending. That would be a range.

Q Has Associates filed a perfection in this Court establishing its perfection on the lease payments from Lane Freight?
A We have filed, yes.
MR. ADERHOLT: We'll pass the witness, Your Honor.
THE COURT: Mr. Barron, do you have any questions of this witness?
MR. BARRON: Yes, Your Honor.

CROSS-EXAMINATION

BY MR. BARRON:

Q Mr. Copple, you are Mr. Dirk Copple, is that correct?
A Yes, sir, that is correct.
Q How long have you been at Associates?
A I've been there for two years.
Q And how old are you?
[13] A I'm twenty-four years old.
Q Have you been buying or selling trucks since you've been at Associates?
A Yes, I have.
Q How many trucks have you bought?
A How many trucks have I bought?
Q Yes, sir.
A At foreclosure sale, I would estimate—I'm estimating here—probably fifteen to twenty-five.
Q You've gone to—you've held a foreclosure sale or Associates has repossessed the truck and sold it?
A Yes. That's what I mean by actually buying the equipment at foreclosure sale.
Q Would you consider that to be an open market, the foreclosure sale?
A No, I would not.
Q. And the values that you receive at those foreclosure sales, as a percentage of the value that you just described to the Court, what would it be?
A Meaning—

Q If you went to foreclosure sale on this vehicle that you just said to the Court was worth $41,000 on the market, what would you receive at the foreclosure sale?

A Most generally, nobody shows up at the foreclosure sales, but we try to obtain the market value, which is the retail [14] value.

Q Well, you've been to fifteen to twenty-five sales, and you've already told me that the value is not the same. So, as a percentage, what would the value be?

A Repeat your question. I'm not understanding where you're coming from on that.

Q Okay. You've told us that you've been to fifteen to twenty-five foreclosure sales.

A Yes, sir.

Q I think you told us that the value received at the foreclosure sales is not the market value of the truck. Didn't you tell us that?

A I don't believe I said that.

Q Well, then, let me ask you, I'll ask it again, then.

A Okay.

Q Is the value that you receive at your foreclosure sales the market value of the truck?

A Like I stated earlier, most the time no one shows up, but what we try to sell it for at the foreclosure sale is the market value.

Q I understand what you try to do. I'm going to ask it one more time. My question is: What value do you receive as a percent of that value you try to receive?

A I can't answer that. I mean, it varies depending on the value and shape of the equipment. I can't answer that [15] honestly.

Q Well, can you give us a range? 50 percent to 60 percent? Some kind of a range.

A Normally it sells for the average finance value, which would be about 10 percent lower.

Q 10 percent lower?

A Yeah.

Q So, at the foreclosure sale, of these fifteen to twenty-five foreclosure sales that you've been involved in, you received 90 percent of the value of the equipment?

A As I stated, we buy the equipment back at the foreclosure sale, and we bid approximately 10 percent less than the retail value of the equipment.

Q Have you ever had anybody besides yourselves bid on this equipment?

A Yes, sir, I have.

Q Other than yourselves, what do other people bid on the equipment?

A Of course, people that show up to these sales, they're always in for a bargain, and most the time they don't get that bargain, but I'll say, on the average, more than the average finance value, which I stated at 10 percent, and a little less than the retail value is what they're trying to get, so I'd say somewhere between, as far as the retail value, a little less than—just, say, on an average, if I [16] had to give a number, I'd say 8 percent less. In other words, trying for a bargain at the sales.

Q At a foreclosure sale of this equipment, people are willing to pay 90 percent plus of its retail value? That's what you're telling this Court?

A In the cases—yeah, as long as the equipment is in good shape, they're willing to pay.

Q Well, then, I guess what that means is that every one of these fifteen to twenty-five foreclosures that you've just described, someone else has bought the equipment, because all you were going to pay was 90 percent. Is that accurate?

A No, like I said, sometimes people don't even show up to them, so they can't—

Q Well, the ones that they have showed up, and you've testified that they're going to bid 92 plus percent of the retail value, I guess you sold that equipment to them; is that right?

A On some cases I have sold equipment at the sales.

Q Of these fifteen to twenty-five cases, how many, approximately, did Associates end up buying?

A If, say, take the number fifteen, we probably bought back twelve of them.

Q Twelve of them. So, then, we're talking about three cases, then, that someone paid 92 percent or more at foreclosure sale?

[17] A But what you've got to realize, there's probably ten of those—

THE COURT: Answer his question. Don't—

THE WITNESS: Okay.

A Repeat the question.

BY MR. BARRON:

Q Of the three cases remaining, then, is that the cases that you say that the public is out there coming to these foreclosure sales and paying 92 percent or more of the truck's retail value?

A Yes, sir.

Q And that actually happened?

A Yes. In some of those cases, yes, they have.

Q Not some of them. We're talking about three specific cases.

A The three, yeah. Well, I can't recall three specific incidents of, you know, the matter, but, yes, they do.

Q Wouldn't you agree with me, though, that most of the time people that go to the foreclosure sales that Associates have, they generally are going to end up—they offer you 50 to 60 percent of its value? I understand you don't take it, but that's what you get offered?

A You're saying—I didn't hear the numbers you threw out.

Q 50 to 60 percent of its retail value. I understand you don't take that number, but isn't that a fact that's what's [18] offered to you?

A I'd say that's a little low. I think people, when they're coming in for a bargain, they don't try to shoot that low.

Q All right, 60 to 70 percent. Is that fair?

A I would say probably 75 percent.

Q Now, other than participating in foreclosure sales of your own equipment, have you bought any trucks on the open market?

A No, sir, I sure haven't.

Q Have you sold any trucks on the open market?

A No, sir, I sure haven't.

Q This truck that you testified to the Court was worth $41,000, what color is it?

A I don't know the color.

Q Have you seen this truck?

A No, sir, I'm going off of testimony and the tools that I use to book the truck out.

Q How many miles does this truck have?

A I'm not sure.

Q Would the mileage make a difference in its value?

A Yes, it would.

Q Did you consider that when you gave the Court a value?

A I took an average of the four tools that I used. No. I did not.

[19] Q You didn't consider the mileage when you gave the Court a value?

A I considered it would be an average mileage.

Q Does this truck have any damage to it?

A Not that I'm aware of.

Q Does this truck's engine leak oil? Is the transmission okay?

A Not that I'm aware of.

Q Do you know whether or not this truck has been maintained?

A No, sir, I sure don't.

Q Does Associates Commercial—are they a truck dealer?

A No, sir, we're sure not. We're a finance company.

Q You're a finance company. You're not in the business of buying and selling trucks?

A We're in the business of financing trucks, that is correct.

Q You don't have—I withdraw that question. Does Associates have any problem with the insurance that the debtor has on this truck?

A No, not that I'm aware of. It is covered.

Q We provided a copy of that to your attorney at the 341 meeting. That's not in issue?

A That is not in issue, no, sir.

Q The insurance is fine?

[20] A At this time it's not an issue.

Q Do you have—I heard you tell the Court about this big maintenance coming up and problems that you might have in the future. Do you have any knowledge as to whether or not the maintenance is current on the truck and it's being maintained as we stand here today?

A No, sir, I do not know if it has been maintained.

Q Now, you have looked at the loan application, I assume, with Mr. Rash in this case, and you know that this truck—would you believe this truck would be necessary for him to operate his business?

A Do I deem it necessary to operate his business?

Q Would you believe this truck is necessary for him to operate his business?

A Yes, sir.

Q Another point that Associates is here claiming today is that you have a lien on cash collateral, I assume from the revenue of the truck. What is it in your loan agreements that gives you a—your loan agreements have a lien on the truck, you've got a lien on the truck title, don't you?

A Uh-huh.

Q Other than that, what is it in your agreements that make you believe that you have a lien on the revenues of Mr. Rash and his truck?

A There's nothing in there that says that.

[21] MR. BARRON: Pass the witness.

REDIRECT EXAMINATION

BY MR. ADERHOLT:

Q Mr. Copple, have you participated—in fact, I believe you testified earlier that you had participated in many purchases and sales that Associates had financed; is that correct?

A That's correct.

Q Would you say that that's been hundreds of them?

A As far as the number of deals coming across the desk?

Q Yes.

A I'd say more than fifty, at the credit desk.

Q And are these purchases that are made that Associates participates in as a lender at the retail value?

A Average finance value, yes.

Q But is that interpreted by the parties that are purchasing it as a retail value?

A Yes.

MR. ADERHOLT: That's all I have of this witness, Your Honor.

MR. BARRON: No further questions, Your Honor.

THE COURT: Mr. Copple, you may step down.

MR. ADERHOLT: I call Mr. Thibodeaux.

MR. BARRON: Your Honor, Mr. Thibodeaux is my expert witness, and he's not under subpoena. He's out in the [22] courtroom at this time.

MR. ADERHOLT: Then that's all we have, Your Honor. If he objects to calling him, that's all right with me.

THE COURT: I don't think you have a right to call him under cross-examination, anyway.

MR. ADERHOLT: Yes. Well, that's all we have, Your Honor.

THE COURT: You rest?

MR. ADERHOLT: We do.

CREDITOR RESTS

THE COURT: Mr. Barron?

MR. BARRON: Your Honor, we would call Mr. Steven Thibodeaux.

(Witness sworn)

DEBTOR'S EVIDENCE

STEVEN THIBODEAUX, DEBTOR'S WITNESS, SWORN

DIRECT EXAMINATION

BY MR. BARRON:

Q Would you state your name, please, sir.
A Steven Thibodeaux.
Q How are you employed?
A By Smart's Truck & Trailer.
Q What do you do out there?
A Salesperson.
Q Salesperson?
[23] A Uh-huh.
Q And how long have you been out there?
A Ten years.
Q How old are you?
A Thirty-two.
Q What is Smart's Truck & Trailer in the business of?
A Trucks.
Q Do you buy and sell trucks?
A Buy and sell, repair and all, yes.
Q We think of a car dealership. You all a truck dealership, is that accurate?
A Yes, sir.
Q What lines do you carry?
A White GMC and GMC medium-duty.
Q Even though those are the lines that you carry and sell, are you as familiar with other types of trucks?
A Yes, sir, I am.

Q Have you bought and sold all types of trucks in the last ten years?
A Yes, sir.
Q Do you all also have a used-truck lot?
A Yes, sir, we do.
Q Do you carry Kenworths on that lot?
A From time to time, yes.
Q Have you had the opportunity to inspect a 1989 Kenworth [24] that's owned by Mr. Rash?
A Yes, sir, I have.
Q And that was a 1989 Kenworth T-600A. Have you looked at that truck?
A Yes, sir, I have.
Q When did you do that?
A I think about April, the end of April.
Q Did you look it all over?
A Yes, sir, I did.
Q Check the mileage on it?
A Yes, sir.
Q And look at the engine, the transmission?
A Yes, sir.
Q Completely inspect the truck?
A Yes, sir, I did.
Q What was the purpose of that inspection?
A To give him a wholesale value of the truck.
Q Did you arrive at a value of that truck?
A Yes, sir, I did.
Q What is that value?
A Thirty-one. eight seventy-five is the value I gave him.
Q $31,875?
A Correct.
Q How did you arrive at that value in addition to inspecting it?
[25] A Well, I took the figures from the truck blue book to establish the retail price, backed off 25 percent for wholesale price.

Q Did you consider in that number, $31,875, the condition of the truck and what it looked like to you?

A Yes, sir, I did.

Q Is that the amount that you would pay to Mr. Rash or Associates Commercial if they brought it in to you to sell it to you?

A Yes, sir.

Q Would you pay any more than that for it, or is that exactly what you would pay for it?

A I don't think I'd pay any more.

Q Did the truck appear to be maintained properly?

A To the best of my knowledge, yes.

Q Well, you're about the only expert we've got. You're in the business. Did it look to you like it was being maintained properly?

A Yes, sir, it did. It looked like it has, yes, sir.

Q Did you see anything on there that was wrong or should have been done differently?

A No, not really, no.

Q What color is that truck?

A It's a brownish.

MR. BARRON: I pass the witness.

[26] CROSS-EXAMINATION

BY MR. ADERHOLT:

Q Mr. Thibodeaux, did you not deliver to Mr. Barron a statement that the retail value of this vehicle was $42,500?

A On the sheet that I turned in to Mr. Rash—and he carried it over to Mr. Barron—there was a retail and wholesale number on it, yes, sir.

Q And you signed it?

A Correct, sir.

Q And that was true, wasn't it?

A Yes, sir.

Q And you said the retail value on that day—and when was that?

A I think it's in April, about April 27, 28.

Q You said that the retail value was $42,500 in April of this year?

A Yes, sir, according to the truck blue book.

Q Now, a three-year-old vehicle that's been on long haul, is there an overhaul coming due pretty soon, on the average?

A Probably in another couple of hundred thousand, to my knowledge.

Q So, that cost is—what would be the range of the cost of that, three to ten thousand, four to ten thousand dollars?

A Yes, sir.

Q That's what you all charge all the time, isn't it, for [27] that kind of thing?

A Yes, sir.

Q Now, if Gulf Coast Kenworth just closed a sale on an identical vehicle for $45,000, would you say that's unreasonable?

A Say that one more time, now?

Q If Gulf Coast Kenworth had conducted a sale, a retail sale of this identical kind of vehicle just last week for $45,000, would you say that's unreasonable?

A No, sir, not as a retail sale. No, sir, it's not.

Q Of course, if you as the dealer at a Smart's dealership, if you buy a vehicle, then you've got to figure some make-ready costs in order to get this ready for retail purposes?

A Reconditioning.

Q You're going to have to figure salesman commission to pay people like you?

A Right.

Q Is that right?

A Right.

Q And so you can't pay retail value if you're going to make a profit?

A Not as a dealer, no, sir, I cannot.

Q That's right. Now, people coming onto your floor, then, who are going to buy a vehicle like Mr. Rash's vehicle that you've described here, in average good condition, you stick [28] with your figure that you would try to get $42,500 for it?

A No, sir, I don't. I said as a wholesale figure of $31,875 is where I would be.

Q I understand. What I'm talking about is, if you have a customer come in onto the floor—

A Okay, I'm sorry. Yes.

Q —to buy it from you.

A Somewhere right in there, yes, sir.

Q And you think that's pretty fair and reasonable?

A To the best of my knowledge, yes, sir.

Q I understand that's the best you can do. There's no doubt in your mind, is that right?

A None.

MR. ADERHOLT: No further questions, Your Honor.

REDIRECT EXAMINATION

BY MR. BARRON:

Q Mr. Thibodeaux, Associates Commercial is not in the business of buying or selling trucks, are they? They don't have a retail lot, do they?

A Not to the best of my knowledge, no.

Q They finance trucks?

A Correct.

Q Would the amount that Associates Commercial would be able to receive for this truck today be about the same that Mr. Rash would receive for this truck if he traded it in?

[29] MR. ADERHOLT: Objection, Your Honor. He doesn't know what Associates could or couldn't do. That's a highly speculative kind of thing. I really think that's outside the fair—

THE COURT: Without some foundation that he would know that, I guess that's sustained. I don't know whether he would know that or not.

BY MR. BARRON:

Q If Mr. Rash was to take this truck into the market today and trade it in on another truck—and Mr. Rash is not a dealer, he's not going to get it ready, he's just going to sell it—is the amount that he would receive for that truck $31,875?

A On trade-in?

Q Yes.

A Yes, sir.

MR. BARRON: I pass the witness.

MR. ADERHOLT: Nothing further, Your Honor.

MR. BARRON: Your Honor, I call Mr. Rash.

ELRAY RASH, DEBTOR, SWORN

DIRECT EXAMINATION

BY MR. BARRON:

Q Mr. Rash, how do you use this truck in your business?

A Hauling freight for Lane Freight, You know, it's my only source of income.

[30] Q I'm sorry, would you speak up. I can't hear you well.

A I drive the truck myself and have it leased to Lane Freight. You know, it's my total source of income for me and my family.

Q If you didn't keep this truck, you would have no ability to make your payments under Chapter 13, is that correct?

A That's correct.

Q How many miles does this truck have on it?

A 380,000.

Q How long is the warranty on this truck?

A I have 750,000 on the rear ends. I have a 600,000 extended warranty on the engine.

Q Now, this warranty, does that cover this overhaul stuff that you heard Associates Commercial talking about?

A I would think so, with the exception of the labor. Cummings pays the parts. I would have to pay the labor.

Q But all that's anticipated in the warranty that you still have a whole lot of miles left on, is that correct?

A Yes, sir, sure do.

Q Have you been maintaining the truck?

A I sure have.

Q What have you been doing in that regard?

A I grease it every 3,000 miles. I change oil, the engine, you know, filters and all that ever 10,000 miles.

Q Is this truck fully insured?

[31] A Yes, sir, it is.

Q Did you sign or do anything to give Associates Commercial a lien on your truck revenues?

A Not to my knowledge.

Q Have you been making all of your Chapter 13 payments?

A Yes, sir, I sure have.

Q How much are your payments?

A Nine twenty-five, I think. I'm not for sure. I believe it's nine twenty-five.

Q And are you current with those?

A Yes, sir.

Q I believe your case is set for confirmation July 22?

A Yes, sir.

Q And do you have any reason to believe it won't be confirmed on that day?

A No, sir.

Q Is the money that you're paying to the trustee right now being held by the trustee pending confirmation?

A That, I don't know. I just pay it to the trustee. I guess it is. I'm not familiar with that part of it.

Q I understand, but you have made every payment that you're scheduled to make?

A Yes, sure have.

Q Have you been making those on time?

A Yes, sir.

[32] MR. BARRON: I pass the witness, Your Honor.

THE COURT: Do you have any cross-examination?

MR. ADERHOLT: No, Your Honor.

THE COURT: You may step down, Mr. Rash. Do you have any further witnesses, Mr. Barron?

MR. BARRON: No, Your Honor. Debtor will rest.

DEBTOR RESTS

THE COURT: Mr. Aderholt, do you have any rebuttal?

MR. ADERHOLT: No rebuttal, Your Honor.

THE COURT: Do you have any closing argument?

MR. ADERHOLT: I do, sir.

CLOSING ARGUMENT ON BEHALF OF CREDITOR

MR. ADERHOLT: Your Honor, in the motion to prohibit the use of collateral that Associates filed—and we would ask for the Court to additionally take notice of our lien perfection which was filed on May 14 in this case—

THE COURT: I have no evidence of that at all, Mr. Aderholt.

MR. ADERHOLT: Well, the debtor testified that there was a lease, and the creditor, Associates, testified that we had filed a perfection of that lien, and under 363(a) lease proceeds are additional cash collateral, and we are asserting that lien claim on those. It is uncontroverted that those lease payments—that this equipment has been leased and that we are entitled to those rent proceeds under 363(a). [33] We're entitled to all of them. As part of our argument, we would suggest to the Court adequate protection payments to maintain our depreciating collateral. We would be satisfied with an amount of the contract payments, which is $1,408 a month. I believe the testimony from the debtor was that he gets $1,200 a week from Lane Freight under that lease, and so we are —it's our position that we would be adequately protected with just contract payments of $1,408 per month.

THE COURT: Your contract shows $1,610 a month.

MR. ADERHOLT: Yes, sir, there is part of Exhibit 1, a reschedule, which we extended the debtor a rescheduling, reducing that from $1,600 to $1,400—

THE COURT: $1,408.33.

MR. ADERHOLT: —even though the debtor never made a payment under that, because he testified that his last payment was in January, January 16, 1992.

Your Honor, just another minute. What we are suggesting, and our testimony has shown, is that Associates has got a very particular risk. When we've got an on-the-road truck like this, the risk of intervening liens, the risk of—or threat to our lien position is extremely high when a debtor in bankruptcy cannot obtain money to pay for mechanic's liens, and this is just an ordinary experience of these truckers. If we are maintained at our payoff debt, if there is a parity between debt and value—and that's our [34] testimony, is that it was worth $41,000 in average condition, and we believe that that's the only testimony here as to what the retail market is. Mr. Thibodeaux went into a lot of discussion about what wholesale dealers would give. That's not the issue here. The question is what could we get between a willing buyer and a willing seller at retail, and Associates is not interested in foreclosing and having a foreclosure on this vehicle. We would hold it until we got a retail value for it. That would be ridiculous for us to have a deficiency on this vehicle in a bankruptcy situation. We would want and we would expect to get the retail, and debtor's expert testified that he thought the retail value was right at forty-two to forty-one thousand dolars. Now, it's Mr. Copple's —the blue book industry statement is that the value of this vehicle right now is $40,000, $40,050, to be exact, but the risk that Associates has is an intervening mechanic's lien, and it just occurs all the time on equipment that's three years old, that's got 400,000 miles on it.

THE COURT: But that's not a risk that the bankruptcy creates. That's a risk that Associates is in every time they finance a truck. That's not anything unusual.

MR. ADERHOLT: That's correct. However, the payments and the value are in parity, unless we have a bankruptcy filing and we don't get paid our contract payments, and that's when the debt then becomes a greater risk if we are [35] stopped from realizing any adequate protection. And what the debtor proposes—and we've got an objection to the plan, but the risk right now that we're having is that that vehicle is on the road running right now, and our debt and the value are at parity, and if we have an intervening lien and there's no way for us to get paid by this debtor, and his payments are nine hundred, I think he said, that is just absurd. There's no way in the world, if he's getting twelve hundred a week. Lease payments, we have a lien on. We have a right to that lease payment under 363(a), and we're conceding and all we want is to be maintained as we go with the value, and we simply cannot undergo this risk without any kind of continuing payments or we're going to be in serious—we're going to be under water in a serious condition.

THE COURT: Mr. Barron?

CLOSING ARGUMENT ON BEHALF OF DEBTOR

MR. BARRON: Your Honor, the debtor would submit that the only credible evidence that the Court has heard today on value is from the appraiser that's independent and doesn't really have an interest in this case. The value that he set was $31,875.

This argument about wholesale and retail is an argument that I've done my best to avoid the Court ruling on and having to make a decision in this area. I think the Court can still avoid a ruling in that area today because of the [36] testimony, the expert opinion testimony. The reason that I've been avoiding this retail/wholesale argument on these vehicles is that it creates a very good tension between the debtor and the creditors and helps get cases settled because nobody is really sure what's going to happen. I would hope that the Court could con-

sider this case strictly on the testimony offered as to value and not make any indication as to "I'm going to use the wholesale" or "I'm going to use the retail," but strictly decide it on the basis of the expert testimony offered. We've had one witness that has had ten years of experience, that buys and sells trucks all day long, that says this truck is worth $31,875. We have another witness that has done no buying and selling of trucks, has conducted foreclosure sales, has not even seen the vehicle in question, and I think that substantial weight of the evidence would go towards considering the value of $31,875, as established by the debtor's witness. That is in relation to the claims hearing, Your Honor.

As far as the motion to lift stay is concerned, the debtor concedes there is no equity in the vehicle. However, I believe the debtor has proved that it's necessary to reorganization—in fact, the creditor's representative admitted that it would be necessary for debtor's reorganization that creditor has no problems on the insurance. The debtor has testified and the debtor's expert [37] witness has testified that the truck is being maintained and does appear to have all the proper maintenance schedules met on it. There is a warranty on the truck that would cover any major problems with it for the next several hundred thousand miles, and the debtor is current on his Chapter 13 payments. The plan is set for confirmation on July 22. As soon as the plan is confirmed, the trustee will be again issuing payment to Associates Commercial.

As far as the cash collateral issue, Your Honor, I'm still at a loss on that one. I have requested, in writing, a copy of the security interest on lease payments and I've gotten no response to that, and then we've listened to it today, and I've heard no response to it. Yeah, there's money coming in made by the truck. That's what it's supposed to do. But there is no document granting a security interest in this collateral. The Bankruptcy Code itself does not give a security interest, and I think that's

what the creditor is saying. If that's what he's saying, the Bankruptcy Code doesn't give a security interest. There is no evidence before the Court of any security interest in any revenue that this truck produces. So, I would submit that the motion to prohibit use of cash collateral must be denied. I would submit that the value of this vehicle should be set at $31,875 and that the motion to lift stay should be denied, except that adequate protection might be required that the [38] debtor maintain insurance and continue making his Chapter 13 payments.

Thank you, Your Honor.

RULING OF THE COURT

THE COURT: Well, as far as the motion to prohibit use of cash collateral, I agree with Mr. Barron. There has to be some kind of a document that grants a prepetition interest in the products and the offspring, et cetera, as the Code is—and the money that property produces. The collection manager concedes that he has no such document as that, and I think that 363 of the Code does provide that cash collateral extends to proceeds, products, offsprings, rents or profits as provided in 552(b), but 552(b) only allows that if there is a prepetition document that the parties have entered into granting that kind of a security interest. So, the motion to prohibit use of cash collateral is denied.

Mr. Barron, would you prepare an order.

MR. BARRON: Your Honor, I think I submitted an order with our response. If the Court has it, it would probably do; if they don't, I'll send another one.

THE COURT: You did.

MR. ADERHOLT: Your Honor, perhaps I was remiss in pointing out—

THE COURT: Mr. Aderholt, do not start making arguments while I'm ruling.

[39] MR. ADERHOLT: I'm sorry.

THE COURT: As to the question of the value of the vehicle, which is the question that's going to have to be answered to rule on both the objection to the allowance of claim and the motion for relief from stay, I believe, Mr. Barron, that this hearing has squarely placed this Court in a position where I'm going to have to adopt either the wholesale or the retail value. We have, clearly, testimony from the only expert in this case that retail value of this vehicle is $42,000, that the wholesale value is $31,850, and we clearly have a situation where the debtor is arguing for the wholesale value and the creditor is arguing for the retail value, and I know that that question has been considered by various bankruptcy courts around the country, and I know of at least two cases where the wholesale value has been determined to be the proper value to be used in connection with automobiles, but in that case they were dealing with family cars, not with trucks that were on the road producing income. I'm not prepared today, gentlemen, without looking at that, to rule on that. I think that is a very important question, and I think once we adopt that position, we are going to be pretty well tied to it, until an appellate court tells us otherwise, and I'm not aware of an appellate court, or certainly not the Fifth Circuit, having given us any guidance on that. All that by way of saying, [40] gentlemen, that I'm going to consider that question, and that question is going to be dispositive of both of these motions, and I'm going to have to consider that and get you a ruling out on it in a matter of a few days.

MR. BARRON: Does the Court desire us to submit any law on that?

THE COURT: Beg your pardon?

MR. BARRON: Does the Court desire us to submit any law on that within a certain—

THE COURT: If you gentlemen desire to submit any arguments or any briefs on that issue, please feel free to do so, and I will consider that .

MR. BARRON: Can we have about ten days, Your Honor, for that? It's important to me.

THE COURT: Yes, you can have ten days on that before I'll get a ruling out.

So, the matter is under advisement.

MR. ADERHOLT: Will the Court let me make a statement to the Court on one of these matters, if I could, please?

THE COURT: No. We've had the hearing, Mr. Aderholt. It's over.

MR. ADERHOLT: Will the Court allow me a bill to state what I was going to present to the Court on a matter?

THE COURT: Well, you have your appellate rights, if you don't like my ruling, Mr. Aderholt. I don't understand [41] what you're trying to do.

MR. ADERHOLT: What I think I have the right to do is to show, under a bill, what I am offering to the Court to show on the motion to prohibit use of collateral.

THE COURT: Mr. Aderholt, I have ruled on that motion. Now, you may request a rehearing, or you may appeal that decision.

MR. ADERHOLT: We'll file a motion for rehearing, then.

THE COURT: That's the proper procedure for you to use if you are not satisfied with my ruling.

MR. ADERHOLT: Thank you, Your Honor.

(Proceedings concluded at 12.20 p.m.)

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF TEXAS
BEAUMONT DIVISION

[Caption Omitted]

ORDER

The Motion of Associates Commercial Corporation for Relief from Stay and the Objection of Debtors to allowance of claim of Associates Commercial Corporation came before the Court for consolidated hearing. The Court considered the pleadings, the evidence adduced, the arguments and briefs of counsel and for reasons contained in a written opinion dated contemporaneously herewith, it is:

ORDERED, ADJUDGED AND DECREED that the Motion for Relief from Stay be and it is hereby DENIED.

It is further ORDERED, ADJUDGED AND DECREED that Associates Commercial Corporation's secured claim is $31,875.00 and the remainder of its claim is unsecured.

SIGNED this 31st day of December, 1992.

/s/ Donald R. Sharp
DONALD R. SHARP
United States Bankruptcy Judge

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF TEXAS
BEAUMONT DIVISION

[Caption Omitted]

FIRST AMENDED CHAPTER 13 PLAN

ELRAY RASH and JEAN E. RASH, Debtors, propose this Plan for the adjustment of their debts.

1. Debtors submit to the supervision and control of the Trustee such portion of their future earnings and income as is necessary for the consummation of this Plan.

2. Debtors shall pay in full, in deferred cash payments, all claims which are entitled to priority under Section 507 of the Bankruptcy Code.

3. Beginning 30 days from the date the Chapter 13 Plan was filed, Debtors will pay to the Trustee $1050.00 each month for 60 months to be distributed in the following manner:

A. The Trustee shall be paid $105.00 each month for 60 months.

B. Debtor's attorney shall receive $835.00 for 2 months beginning April 15, 1992, and then $33.20 for 25 months until a total of $2,500.00 is paid.

C. The Internal Revenue Service shall be paid a total of $2,745.00, without interest, in the following manner: $47.33 per month for 58 months, beginning June 15, 1992.

D. Associates Commercial, which holds a first lien on Debtor's 1989 Kenworth, shall retain its lien, and be paid $679.77 for 58 months beginning June 15, 1992, for a principal total or value of $31,875.00, plus interest at

9% which amounts represent partial payment of the value of the collateral in full with interest over the life of the Plan. Debtor will further keep the collateral insured during the life of the Plan. The undersecured portion of this claim, if any, shall be paid as an unsecured claim as set forth below. This creditor shall release its lien on the collateral securing the debt at such time as all payments have been made as set forth in this paragraph.

E. Chrysler Credit Corporation, which holds a first lien on Debtor's 1988 Dodge Ram 50 Pickup, shall retain its lien, and be paid $108.91 for 36 months beginning April 15, 1992, for a principal total or value of $3,425.00, plus interest at 9% which amounts represent payment of the value of the collateral in full with interest over the life of the Plan. Debtor will further keep the collateral insured during the life of the Plan. The undersecured portion of this claim, if any, shall be paid as an unsecured claim as set forth below. This creditor shall release its lien on the collateral securing the debt at such time as all payments have been made as set forth in this paragraph.

F. First National Bank of Jasper, which holds a first lien on Debtor's 1985 Lufkin flat bed trailer, shall retain its lien, and be paid $74.64 for 58 months beginning June 15, 1992, for a principal total or value of $3,500.00, plus interest at 9% which amounts represent payment of the value of the collateral in full with interest over the life of the Plan. Debtor will further keep the collateral insured during the life of the Plan. The undersecured portion of this claim, if any, shall be paid as an unsecured claim as set forth below. This creditor shall release its lien on the collateral securing the debt at such time as all payments have been made as set forth in this paragraph.

G. The unsecured creditors shall receive in pro-rata amounts all amounts remaining after priority and secured debts are paid.

4. Debtors shall pay the following secured debts outside the Plan:

Secured Creditor	*Amount*	*Collateral*
Community Bank	$15,390.00	716 N. Austin Jasper, TX
GMAC	$ 2,750.00	1987 Buick Regal LE

5. Debtors shall return the following collateral to the secured creditors described in full satisfaction of the debt.

NONE

6. Debtors shall void the non-purchase money security interest in exempt property under Section 522(f) U.S. Bankruptcy Code for the following creditor, and the debt shall be paid as an unsecured claim for this Plan:

NONE

7. Debtors will not incur any post-petition consumer debt except after notice to creditors and approval by the Court and the Standing Chapter 13 Trustee as specified in 11 U.S.C. 1305(c). Post-petition claims will be allowed only as specified in 11 U.S.C. 1305.

8. Upon confirmation of this Plan, the property of the estate shall revest in Debtors.

9. The filing of Debtor's Petition and the Debtor's Plan shall not be construed as a waiver of the Debtor's exemptions as claimed by them in their schedule of exemptions on file herein, as allowed by law.

DATED: January 18, 1993

/s/ Elray Rash
ELRAY RASH

/s/ Jean E. Rash
JEAN E. RASH

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF TEXAS
BEAUMONT DIVISION

[Caption Omitted]

ORDER CONFIRMING THE DEBTOR'S FIRST AMENDED PLAN AND RELATED ORDERS

After notice and a hearing, wherein the Court considered the matters on file herein, including the Trustee's Report of Creditors Meeting held pursuant to Section 341 of the Bankruptcy Code, and all objections to confirmation of the Plan, the Court finds:

1. Written notice of the Meeting of Creditors held pursuant to 11 U.S.C. 341 and of this hearing on the confirmation of the Plan was given as required by Rule 2002; and

2. All scheduled creditors have been served with a copy of the Debtor's Plan, or a summary thereof in accordance with Rule 3015.

3. The Plan as presented for confirmation (hereinafter referred to as "the Plan") complies with the provisions of Chapter 13 of Title 11 of the United States Code and the other applicable provisions of said Title; and

4. With respect to each allowed secured claim provided for by the Plan, the holder of such claims either accepted or was deemed to have accepted the Plan or in the alternative

a. The Plan provides that the holder of such claims retain the lien securing such claims; and

b. The value, as of the effective date of the Plan, of property to be distributed under the Plan on

account of such claim is not less than the allowed amount of such claims; or

c. The Debtors have surrendered or abandoned the collateral securing the claim; or

d. The treatment of the claim complies with 11 U.S.C. Sec. 1322(b)(5).

IT IS ORDERED THAT:

1. The Debtor's Plan, as modified, if any, by this Order, is confirmed.

2. The Debtors shall pay the sum of $1050.00 per month for 60 months for a total of $63,000.00 to Michael Gross, Trustee, payable in Tyler, Smith County, Texas, beginning the 15th day of April, 1992, until all of the allowed claims provided for under the Plan have been paid in accordance with the terms of the Plan, of this Order, or until further order of this Court.

3. The Trustee shall make disbursements pursuant to the provisions of the Plan, as modified, if any, by this Order, Section 1326 of the Bankruptcy Code, and shall pay only such claims which have been allowed by the Court. The Trustee shall make such disbursements monthly, unless otherwise provided by the Plan, but shall not be required to pay any dividend in an amount less than $15.00 and dividends not distributed because of this provision shall accumulate and be paid when such accumulation aggregates $15.00 or more.

4. The Debtors shall not incur additional debt during the term of this Plan except upon written approval of the Trustee. Failure to obtain such approval may cause the claim for such debt to be unallowable and non-dischargeable.

5. The order of payment, unless otherwise directed, shall be:

a. The percentage fee fixed for the Trustee pursuant to 11 U.S.C. Sec. 1302(e);

b. Any unpaid claim of the kind specified in Section 507(a) of Title 11 U.S.C.;

c. Creditors whose claims are timely filed and allowed in such amount and order of preference as may be provided by the Plan or as may be required to provide adequate protection of the interest of an equity with an interest in property of the estate as ordered by the Court, or as deemed necessary within the discretion of the Trustee.

6. The following secured claims are known to the Court at this time and are allowed as follows:

Name of Creditor	*Allowed Amount of Claim*	*Rate of Interest*	*Monthly Payment*	*Total Amt. To Be Paid*
Associates Commercial	**$31,875.00**	**9%**	**$679.77 on 6-15-92 for 58 mos.**	**$39,426.66**
Chrysler Credit Corporation	**$3425.00**	**9%**	**$108.91 on 4-15-92 for 36 mos.**	**$3920.76**
First National Bank of Jasper	**$3500.00**	**9%**	**$ 74.64 on 6-15-92 for 58 mos.**	**$4329.12**

7. The following secured claims are not dealt with in the Debtor's Plan, and therefore, the automatic stay provisions of 11 U.S.C. Sec. 362 are hereby terminated and annulled with respect to each of the following claims:

NONE

8. The Debtors, in lieu of the Trustee, shall reaffirm and make disbursements on the following portions of secured claims dealt with in the Plan under 11 U.S.C. Sec. 1322.

Name of Creditor	*Total Amount Paid During Plan*	*Monthly Payment*
Community Bank	**Balance of Note**	**$371.00**
GMAC	**Balance of Note**	**$194.87**

9. The following Administrative, Attorney Fee and Priority Claims are known to the Court at this time and are allowed as follows:

Name of Creditor	*Allowed Amount of Claim*	*Rate of Interest*	*Monthly Payment*	*Total Amt. To Be Paid*
Trustee	**$6300.00**	**-0-**	**$105.00**	**$6300.00**
Robert E. Barron Attorney	**$2500.00**	**-0-**	**$835.00 on 4-15-92 for 2 mos. $ 33.20 on 6-15-92 for 25 mos.**	**$2500.00**
IRS	**$2745.00**	**-0-**	**$ 47.33 on 6-15-92 for 58 mos.**	**$2745.00**

10. Debtors shall return the following collateral to the secured or priority creditor described in full satisfaction of the debt.

NONE

Each secured creditor described herein shall retain the lien existing prior to the commencement of the case to secure payment of the allowed amount of its claim.

The foregoing provisions regarding secured claims are based upon claims that have been filed or otherwise disclosed to the Court as of this date. The Court retains jurisdiction to review this Order upon the request of any interested party if additional claims are filed and allowed subsequent to the entry of this Order, which would render inaccurate the Court's findings in paragraphs 3 and 4.

SIGNED this 20th day of January, 1993.

/s/ Donald R. Sharp
DONALD R. SHARP
United States Bankruptcy Judge

[Filed Sep. 24, 1993]

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF TEXAS
BEAUMONT DIVISION

Nos. 1:93CV-0078
1:93CV-0079

ASSOCIATES COMMERCIAL CORPORATION

vs.

ELRAY RASH and WIFE JEAN RASH

JUDGMENT

For the reasons set forth in the Memorandum Opinion signed and filed on September 14, 1993, the Court renders judgment for the Appellees. The decisions of the bankruptcy court are therefore AFFIRMED.

Signed this 24th day of September, 1993.

/s/ [Illegible]
United States District Judge

[Filed Sep. 27, 1993]

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF TEXAS

[Caption Omitted]

NOTICE OF APPEAL TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

Associates Commercial Corporation, the Plaintiff, appeals to the United States Court of Appeals for the Fifth Circuit from the final judgment of the District Court for the Eastern District of Texas entered in this case on September 16, 1993, captioned as the "Memorandum Opinion" and which affirmed the decision of the Bankruptcy Court Order appealed from.

The parties to the judgment appealed from and the names and addresses of their respective attorneys are as follows:

Robert E. Barron
PO Box 1347
Nederland TX 77627
(409) 727-0073
Attorney for Debtors

Michael Gross
PO Box 7190
Tyler TX 75711
Trustee

Dated [23] September, 1993

Respectfully submitted,

HIRSCH, ROBINSON, SHEINESS
& GLOVER, P.C.

By: /s/ Tina Snelling
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Tina Snelling
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Attorneys for Plaintiff
Associates Commercial
Corporation

[Certificate of Service Omitted]

[Filed Oct. 1, 1993]

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF TEXAS

[Caption Omitted]

NOTICE OF APPEAL TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

Associates Commercial Corporation, the Plaintiff, appeals to the United States Court of Appeals for the Fifth Circuit from the final judgment of the District Court for the Eastern District of Texas signed on September 24, 1993 and entered in this case on September 27, 1993, in Volume 242, at Page 160 which affirmed the decision of the Bankruptcy Court Order appealed from.

The parties to the judgment appealed from and the names and addresses of their respective attorneys are as follows:

Robert E. Barron
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Attorney for Debtors

Michael Gross
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Tyler TX 75711
Trustee

Dated 30th September, 1993.

Respectfully submitted,

HIRSCH, ROBINSON, SHEINESS
& GLOVER, P.C.

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[Certificate of Service Omitted]

[Filed Oct. 6, 1993]

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF TEXAS

[Caption Omitted]

AMENDED NOTICE OF APPEAL TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

Associates Commercial Corporation, the Plaintiff, appeals to the United States Court of Appeals for the Fifth Circuit from the final judgment of the District Court for the Eastern District of Texas signed on September 24, 1993 and entered in this case on September 27, 1993, in Volume 242, at Page 160 which affirmed the decision of the Bankruptcy Court Order appealed from.

The parties to the judgment appealed from and the names and addresses of their respective attorneys are as follows:

John J. Durkay
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Requesting Notices In This Appeal

Michael Gross
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Dated 5th October, 1993.

Respectfully submitted,

HIRSCH, ROBINSON, SHEINESS & GLOVER, P.C.

By: /s/ Tina Snelling
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Attorneys for Plaintiff
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[Certificate of Service Omitted]

[Filed Jul. 30, 1996]

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 93-5396

D.C. Docket No. 1:93-CV-78

IN THE MATTER OF: ELRAY RASH; JEAN E. RASH,
Debtors

ASSOCIATES COMMERCIAL CORPORATION
Appellant

v.

ELRAY RASH; JEAN E RASH,
Appellees

Appeals from the United States District Court
for the Eastern District of Texas, Beaumont

Before POLITZ, Chief Judge, REYNALDO G. GARZA, KING, JOLLY, DAVIS, SMITH, DUHÉ, WIENER, BARKSDALE, EMILIO M. GARZA, DEMOSS, BENAVIDES, STEWART, PARKER and DENNIS, Circuit Judges.*

* Judges GARWOOD, HIGGINBOTHAM and JONES are recused and did not participate in this decision.

JERRY E. SMITH, Circuit Judge, with whom REYNALDO G. GARZA, DUHE, BARKSDALE, EMILIO M. GARZA and DEMOSS, Circuit Judges, join, dissents:

JUDGMENT

This cause came on to be heard on the record on appeal and was argued by counsel.

ON CONSIDERATION WHEREOF, it is now here ordered and adjudged by this court that the judgment of the district court in affirming the judgment of the bankruptcy court in this cause is affirmed.

IT IS FURTHER ORDERED that appellant pay to appellees the costs on appeal to be taxed by the Clerk of this Court.

ISSUED AS MANDATE: Aug. 29, 1996

A true copy

Test

Clerk
U.S. Court of Appeals
Fifth Circuit

By /s/ Latonya Walker
Deputy Clerk

New Orleans, Louisiana

(5)

No. 96-454

Supreme Court, U.S.
FILED
DEC 23 1996
CLERK

IN THE
Supreme Court of the United States

OCTOBER TERM, 1996

ASSOCIATES COMMERCIAL CORPORATION,
Petitioner,
v.

ELRAY RASH AND JEAN E. RASH,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

---

REPLY BRIEF OF PETITIONER

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1996

No. 96-454

ASSOCIATES COMMERCIAL CORPORATION,
Petitioner,

v.

ELRAY RASH AND JEAN E. RASH,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

---

REPLY BRIEF OF PETITIONER

The issue presented in this case—as described by the bankruptcy court, the district court, the court of appeals panel and the *en banc* Fifth Circuit—is "whether the appropriate standard of valuation of a vehicle in Chapter 13 is the retail or the wholesale value." Pet. App. 111a. See *id.* at 84a (district court); *id.* at 102a (panel opinion); *id.* at 2a (*en banc*). That issue has created an extraordinary conflict between the Fifth Circuit *en banc* and the Ninth Circuit *en banc*—to which, just recently, the Seventh Circuit added yet a third point of view. *In re Hoskins,* 1996 WL 714104 (7th Cir. Dec. 12, 1996) (use of value midway between retail and wholesale value). Indeed, the United States has urged the Court to grant the petition in this case because it is frequently a creditor and the issue presented here recurs often. U.S. Br. 7. It is difficult to imagine a case more worthy of certiorari.

Respondents offer four reasons to deny the petition. None remotely has merit.

1. Respondents assert (Opp. 3-5) that the record in this case does not properly frame the legal question presented. In making this claim, respondents simply ignore the 119 pages in the appendix to the petition analyzing the valuation questions strictly as a matter of law.

Specifically, respondents assert that petitioner's proof concerning the value of the collateral in the hands of respondents was not "worthy of weight." The argument is unaccompanied by any citation because it has no support. As the bankruptcy court makes absolutely clear "testimony indicates . . . the truck has a wholesale value of $31,875.00 and a retail value of $42,500." Pet. App. 111a. This factual dispute was then resolved strictly as a matter of law in every court up to this one. The facts have thus presented a simple and completely suitable vehicle for resolving the legal issue presented by petitioner.[1]

2. Respondents' suggestion (Opp. 5-7) that the conflict in the circuits is "illusory" or "shallow" is mere wishful thinking. Respondents concede that *In re Trimble*, 50 F.3d 530 (8th Cir. 1995), is flatly inconsistent with the decision below, but urge the Court to ignore that conflict because the Eighth Circuit might someday adopt the view of the Fifth Circuit.

That suggestion is hard to take seriously after *In re Taffi*, 96 F.3d 1190 (9th Cir. 1996) (*en banc*), *petition for cert. filed* (U.S. Oct. 31, 1996) (No. 96-881), where

[1] Respondents' basic misunderstanding is revealed in their assertion "that they have argued throughout the appeals that the bankruptcy court's use of [their] appraisal . . . was not clearly erroneous." Opp. 5. Even if true, the fact remains that each court that has faced the question has decided it as a matter of law, and not as a question of fact.

the full Ninth Circuit categorically and unanimously rejected the holding and reasoning of the majority in this case. Nor can *Taffi* be distinguished.[2] Respondents' contention is even harder to take seriously now that the Seventh Circuit has recognized the conflict between this case and *Taffi*, and adopted an intermediate position between them. *In re Hoskins*, 1996 WL 714104 (7th Cir. Dec. 12, 1996). The key issue in those cases is thus precisely the same as here—the proper method of valuing property that the debtor proposes to keep. On that issue of statutory construction, the Ninth, Fifth, and now the Seventh Circuits are hopelessly conflicted.

3. In the petition, petitioner showed (Pet. 8-11) that the plain language and structure of 11 U.S.C. § 506(a) strongly support its position concerning the proper method of valuation. Petitioner also demonstrated that its interpretation is supported by at least three prior opinions of this Court. Pet. 14-15. In asserting that petitioner's legal reasoning suffers "fundamental flaws," respondents neither quote the language of the statute, analyze its structure, nor even discuss this Court's opinions. In any event, the strength of petitioner's "legal reasoning" is not the issue on certiorari. Suffice it to say that petitioner's arguments have been accepted by the Ninth Circuit *en banc* (in the wake of the Fifth Circuit's decision here), by three other circuits and by the Solicitor General.

4. Respondents argue (Opp. 8-9) that *amicus*' "policy" arguments are flawed. While attacking the position taken by lenders in support of the petition on the ground that their arguments lack "proper statistical substantiation,"

[2] Respondents' proposed distinctions—based on the nature of the IRS' priority in bankruptcy and the difference between real and personal property—are facially irrelevant to valuation and are based on nothing in the *Taffi* court's opinion. The United States certainly saw no distinction between those cases when it urged the Court to grant the petition in this case to resolve this conflict in the circuits.

respondents choose to ignore the data presented by the United States that proves that the issue here is a recurring one. U.S. Br. 7. Those are the only data relevant to certiorari, and they clearly support further review by this Court.

At the end of the day, all of the circuits are "in harmony . . . except the Fifth," (*Taffi*, 96 F.3d at 1193), and now the Seventh. Only this Court can provide the uniformity that the bankruptcy laws require. Accordingly, the Court should grant certiorari.

CONCLUSION

For the foregoing reasons and those stated in the petition, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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(2)

No. 96-454

In the Supreme Court of the United States

OCTOBER TERM, 1996

ASSOCIATES COMMERCIAL CORPORATION, PETITIONER

v.

ELRAY RASH AND JEAN RASH

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE SUPPORTING PETITIONER

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QUESTION PRESENTED

Whether, when a debtor in a bankruptcy case is permitted to retain property that secures the claim of a secured creditor, the allowed amount of the secured claim is to be valued under Section 506(a) of the Bankruptcy Code at (i) the amount the creditor would realize from a hypothetical foreclosure sale of the property or (ii) the fair market value of the property in the hands of the debtor.

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BRIEF FOR THE UNITED STATES AS AMICUS CURIAE SUPPORTING PETITIONER

INTEREST OF THE UNITED STATES

This case concerns whether, when a debtor is permitted to retain property that secures the claim of a secured creditor, the allowed amount of the secured claim is to be reduced, under Section 506(a) of the Bankruptcy Code, to the amount that the creditor would have obtained in a hypothetical foreclosure sale. This issue is of substantial importance to the United States. The United States often becomes a secured creditor under federal programs involving loans, loan guarantees, contracts and tax collection activities. The rights of the United States as a secured creditor are frequently affected by valuations of collateral under Section 506(a). Indeed, the court of appeals acknowledged that its decision in this case conflicts directly with the decision of the Ninth

Circuit in *Taffi* v. *United States*, 68 F.3d 306 (1995), aff'd on rehearing en banc, Nos. 94-55011 & 94-55019 (Sept. 17, 1996), which involved a similar effort by a debtor to reduce a secured claim of the United States to the amount that would be obtained in a hypothetical foreclosure sale.

The opinion of the court of appeals in this case not only conflicts with the en banc opinion of the Ninth Circuit in *Taffi* v. *United States*, *supra*. As petitioner notes (Pet. 6-8), it also conflicts with decisions of the First, Fourth, Sixth, and Eighth Circuits. As a result, the United States and its agencies will now face disparate treatment in different circuits of identical claims arising under national programs. The United States has a substantial interest in the resolution of this recurring conflict.

STATUTORY PROVISIONS INVOLVED

Section 506(a) of the Bankruptcy Code, 11 U.S.C. 506(a), provides:

> An allowed claim of a creditor secured by a lien on property in which the estate has an interest, or that is subject to setoff under section 553 of this title, is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property, or to the extent of the amount subject to setoff, as the case may be, and is an unsecured claim to the extent that the value of such creditor's interest or the amount so subject to setoff is less than the amount of such allowed claim. Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor's interest.

STATEMENT

1. In 1992, respondents Elray and Jean Rash filed for bankruptcy under Chapter 13 of the Bankruptcy Code (Pet. App. 110a). Petitioner Associates Financial Commercial Corporation had provided purchase money financing to respondents and held a lien on a truck that respondent Elray Rash used in his business (*id.* at 111a). Over petitioner's objection, respondents proposed a plan under which (i) respondents would retain the truck for use in the continued operation of the business and (ii) the amount of petitioner's allowed secured claim would be reduced to the wholesale value of the truck (*id.* at 2a, 111a).[1]

The bankruptcy court approved the plan and also approved the debtor's valuation of petitioner's allowed secured claim. The court found that the truck had a wholesale value of $31,875 and a retail value of $42,500 (Pet. App. 111a). The court concluded that, under Section 506(a) of the Bankruptcy Code, the "allowed secured claim" should be valued at the wholesale value of the truck because "wholesale value most often equates to the value in the hands of the creditor after he has deducted his foreclosure and disposition costs so that it is a reasonable indication of the net proceeds he will receive upon the disposition of the

[1] The plan proposed by respondents was a "cramdown" plan, under which the debtor seeks confirmation of a plan despite a secured creditor's objections. In a "cramdown" plan, the amount of the secured claim is reduced to an "allowed secured claim" under the valuation provisions of Section 506(a) of the Bankruptcy Code, 11 U.S.C. 506(a). The portion of the secured claim that is not treated as an "allowed secured claim" under that provision is to be treated as an unsecured claim. *Ibid.* The creditor retains a lien to protect its secured claim. See 11 U.S.C. 1129(b), 1325(a)(5)(B)(i) and (ii).

reclaimed collateral" (Pet. App. 113a). The district court affirmed the bankruptcy court's orders (*id.* at 83a-88a).

2. a. A panel of the court of appeals reversed (Pet. App. 100a-109a). The panel held that, under Section 506(a) of the Bankruptcy Code, the value of the allowed secured claim was the retail or replacement value of the truck in the hands of the debtor, not the wholesale value of the truck (Pet. App. 109a).

b. Respondent filed a petition for rehearing en banc. While that petition was pending, the First, Eighth, and Ninth Circuits issued decisions that agreed with the reasoning and conclusion of the panel decision in this case and with an earlier decision of the Fourth Circuit on this same issue. See pages 5-6, *infra*.

In an en banc decision in which nine judges joined and six judges dissented, however, the Fifth Circuit rejected the panel decision and held that the value of the allowed secured claim must be limited to the wholesale value of the truck—the theoretical amount that the creditor would realize at a hypothetical foreclosure sale (Pet. App. 14a, 51a).

ARGUMENT

The decision of the court of appeals in this case creates a confict among the circuits on a recurring question of substantial importance. Resolution of this issue by this Court is needed to avoid repetitive and wasteful litigation and to ensure evenhanded treatment of debtors under the many federal programs that authorize or establish secured claims for the United States, as well as evenhanded treatment of debtors and secured creditors generally.

1. This case involves the proper valuation of a secured claim in a bankruptcy case when the debtor is permitted to retain the property that secures the claim. When, as in the present case, the debtor proposes to retain such property under a plan to which the secured creditor has objected, the court may approve the plan only if, among other requirements, it ensures that the holder of the secured claim will receive at least the value of the "allowed amount" of the "allowed secured claim." 11 U.S.C. 1325(a)(5)(B). See also 11 U.S.C. 1129(b)(2)(A)(i). The "allowed amount of such claim" is determined under Section 506(a) of the Bankruptcy Code, 11 U.S.C. 506(a). H. R. Rep. No. 595, 95th Cong., 1st Sess. 415 (1977). That Section specifies that a secured claim is to be treated as an "allowed" secured claim only to the extent of "the value of such creditor's interest in the estate's interest in such property" (11 U.S.C. 506(a)). The statute specifies that "[s]uch value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property" (*ibid.*). To the extent that the secured claim exceeds the value thus determined, it is treated as an unsecured claim (*ibid.*).

With the exception of the decision of the Fifth Circuit in this case, all of the courts of appeals that have interpreted the valuation provisions of Section 506(a) have rejected using "foreclosure value" as the measure of value when the debtor retains the collateral. These courts include the Eighth Circuit (*Metrobank* v. *Trimble*, 50 F.3d 530 (1995) (Chapter 13 case valuing pickup truck)), the First Circuit (*Winthrop Old Farm Nurseries, Inc.* v. *New Bedford Institution for Savings*, 50 F.3d 72 (1995) (Chapter 11 case valuing real property used in business)), the

Sixth Circuit (*Huntington National Bank* v. *Pees (In re McClurkin)*, 31 F.3d 401 (1994) (Chapter 13 case valuing real property used as residence)) and the Fourth Circuit (*Brown & Company Securities Corp.* v. *Balbus*, 933 F.2d 246 (1991) (Chapter 13 case valuing real property)); *Coker* v. *Sovran Equity Mortgage Corp.*, 973 F.2d 258 (1992) (same)).

Less than two months after the Fifth Circuit issued its en banc opinion in this case, the Ninth Circuit, also sitting en banc, joined the majority of the circuits by holding unanimously that, when the debtor retains the property that secures the secured claim, Section 506(a) does not permit reduction of the allowed amount of that claim to the foreclosure value of the property. Instead, the Ninth Circuit held that, in this context, the bankruptcy court is to value the allowed secured claim at the fair market value of the property. *Taffi* v. *United States*, Nos. 94-55011 & 94-55019 (Sept. 17, 1996).[2] Noting its disagreement with the en banc decision of the Fifth Circuit in this case, the *Taffi* court held (slip op. 12,713-12,714):

> When a Chapter 11 debtor or a Chapter 13 debtor intends to retain property subject to a lien, the purpose of a valuation under section 506(a) is not to determine the amount the creditor would receive if it hypothetically had to foreclose and sell the collateral. Neither the foreclosure value nor the costs of repossession are to be considered because no foreclosure is intended. * * * Valuation must be accomplished within the actual situation presented. Consequently, the value has to be the fair market value of what the debtors are using.

The conflict between the en banc decision of the Fifth Circuit in this case and the decisions of the First, Fourth, Sixth, Eighth, and Ninth Circuits is direct and irreconcilable. Unless resolved by this Court, this conflict will produce wasteful and repetitive litigation and will result in disparate treatment of secured claims in bankruptcies based solely upon geographical happenstance.

2. a. The question presented in this case is of substantial importance. As the petition notes, more than 286,000 Chapter 13 petitions were filed in 1995 (Pet. 15). The Internal Revenue Service advises us that during fiscal year 1996 (ending September 30, 1996) the Service received notice of 14,034 filings under Chapter 11 of the Bankruptcy Code and 151,174 filings under Chapter 13 of the Code. The Service filed proofs of claim in approximately 162,000 bankruptcy cases during that fiscal year. Approximately 7 percent of these claims (11,340) were filed in Chapter 11 cases and approximately 79 percent (127,980) were filed in Chapter 13 cases. The proofs of claim filed by the Internal Revenue Service during that single fiscal year asserted $329,830,957 in secured claims in Chapter 11 cases and $334,812,254 in secured claims in Chapter 13 cases.

The United States is also a secured creditor in a variety of other contexts. To list only a few examples, the United States may assert liens for payment

[2] As the Ninth Circuit held in *Taffi*, the contrary conclusion reached by the Fifth Circuit in the present case effectively ignores—and makes surplusage of—the statutory command that the value of the allowed secured claim "shall be determined in light of * * * the proposed disposition or use of such property" (11 U.S.C. 506(a)). See also H.R. Rep. No. 595, *supra*, at 356 ("'Value' does not necessarily contemplate forced sale or liquidation value of the collateral; nor does it always imply a full going concern value.").

of penalties under agricultural quota programs and for the repayment of agricultural loans (7 U.S.C. 1314(c), 1339(a)(1), 1340(4), 1927(c)), for repayment of advances made under defense contracts (10 U.S.C. 2307(d)), for payment of certain criminal fines (18 U.S.C. 3613(c)), for payment of customs duties (19 U.S.C. 198), for payment of a judgment lien in favor of the United States in a civil action (28 U.S.C. 3201(a)), for payment of pension benefits under the Employee Retirement Income Security Act (ERISA) (29 U.S.C. 1368(a)), for repayment of black lung benefits (30 U.S.C. 934(b)(2)), for repayment of advances made to a contractor by a government agency (41 U.S.C. 255(d)), for repayment of low-income housing loans (42 U.S.C. 1484(a)(5), 1487(d)(1)), for payment of the costs of removing or remediating hazardous substances (42 U.S.C. 9607(l)(1)) and for payment of charges due under a federal irrigation project (43 U.S.C. 542).

The United States is thus a secured creditor in a large portion of all Chapter 11 and Chapter 13 bankruptcy cases. If the secured claim of the government in these cases were reduced under the foreclosure valuation method endorsed by the court of appeals in this case, the loss of revenue to the Treasury would be substantial.

b. Because of the conflict among the circuits created by the decision in this case, two taxpayers who owe the same amount of tax and possess assets of the same value ultimately may pay significantly different amounts of their federal tax liability depending solely upon the happenstance of geography. This disparate treatment impedes the objective of "ensur[ing] as far as possible that similarly situated taxpayers pay the same tax." *Thor Power Tool Co.* v. *Commissioner*, 439 U.S. 522, 544 (1979). See also *Lyeth* v.

Hoey, 305 U.S. 188, 193 (1938). It similarly prevents the uniform application of all other federal programs that authorize or create secured claims for the government.

Review by this Court is warranted to resolve the continuing conflict among the circuits on the common, recurring question presented in this case.

CONCLUSION

The petition for writ of certiorari should be granted.

Respectfully submitted.

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OCTOBER 1996

(3)

NO. 96-454

In the Supreme Court of the United States

OCTOBER TERM, 1996

ASSOCIATES COMMERCIAL CORPORATION,
Petitioner,

V.

ELRAY RASH AND JEAN RASH,
Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

AMICUS BRIEF BY HIBERNIA NATIONAL BANK IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI BY ASSOCIATES COMMERCIAL CORPORATION

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MOTION FOR LEAVE TO FILE AMICUS BRIEF

Now comes, Hibernia National Bank, an amicus curiae in the Fifth Circuit, and moves the Court for leave to file this amicus curiae brief in support of Associates Commercial Corporation's petition for writ of certiorari. Pursuant to Supreme Court rule 37(2) (b), Hibernia requested consent from counsel representing Elray and Jean Rash, and from the Chapter 13 Trustee of the Rash case, to the filing of this brief. Hibernia's counsel had no reply to her letters of October 9, 1996, or her phone calls of October 16, 1996, from counsel for the Rashes. The trustee has consented. Accordingly, Hibernia National Bank prays that this Court grant it leave to file this amicus brief.

Respectfully submitted,

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QUESTION PRESENTED

Whether, when a debtor proposes to retain a secured creditor's collateral under the cramdown powers of chapter 13 of the Bankruptcy Code, the amount required to be paid on account of the creditor's secured claim is limited to the value that the secured creditor could have obtained if it had sold the collateral at foreclosure.

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ASSOCIATES COMMERCIAL CORPORATION,
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Petition for a Writ of Certiorari to the
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for the Fifth Circuit

AMICUS BRIEF BY HIBERNIA NATIONAL BANK IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI BY ASSOCIATES COMMERCIAL CORPORATION

Amicus respectfully requests that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Fifth Circuit entered in this case, 90 F3d 1036 (5th Cir. 1996) (en banc).

INTEREST OF AMICUS CURIAE

Hibernia National Bank is a national bank, organized under the laws of the United States, with its principal place of business in New Orleans, Louisiana. It has branches statewide in Louisiana. Proceedings in all of the bankruptcy courts in Louisiana are governed by the *Rash* decision.

OPINIONS

The opinions in this matter are listed in petitioner's writ application and are found in its appendix, which amicus adopts herein by reference.

STATUTORY PROVISIONS INVOLVED

11 USC § 506 (a) provides:

(a) An allowed claim of a creditor secured by a lien on property in which the estate has an interest, or that is subject to setoff under section 553 of this title, is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property, or to the extent of the amount subject to setoff, as the case may be, and is an unsecured claim to the extent that the value of such creditor's interest or the amount so subject to setoff is less than the amount of such allowed claim. Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor's interest.

11 U.S.C. § 1325 (a) (5) provides:

(a) Except as provided in subsection (b), the court shall confirm a plan if-

***

(5) with respect to each allowed secured claim provided for by the plan-

(A) the holder of such claim has accepted the plan

(B) (i) the plan provides that the holder of such

claim retain the lien securing such claim; and (ii) the value, as of the effective date of the plan, of property to be distributed under the plan on account of such claim is not less than the allowed amount of such claim; or

(C) the debtor surrenders the property securing such claim to such holder...

STATEMENT OF THE CASE

This case presents an important and recurring issue as to the respective rights of chapter 13 debtors and their secured creditors, which has divided several courts of appeals. Specifically, at issue here is the standard for determining the amount that a debtor is required to pay to his secured creditors when he seeks to retain their collateral, over their objection, in a chapter 13 plan. Is the debtor required, as the court below held, to pay the secured creditor only that amount which the creditor could have received if it had sold the collateral at foreclosure, or is the debtor required, as other circuits have held, to pay the value of the collateral as used by the debtor for the purposes contemplated in the plan (i.e., fair market or retail value)?

Some 250,000 chapter 13 cases are filed each year, and, because the vast majority of debtors have secured loans, the issue presented is likely to arise in most of them, with a resulting annual aggregate economic impact in the hundreds of millions of dollars. Moreover, the question is a fundamental one in bankruptcy, which the court below recognized requires a national uniform rule. Only this Court can provide that uniformity.

SUMMARY OF THE ARGUMENT

The decision below creates an acknowledged conflict among the circuits as to an issue that is fundamental to the administration of the Bankruptcy Code, *viz*, what value must be paid on account of a secured claim if the debtor keeps the collateral? The *en banc* decision not only departs from the views of the other courts of appeals, but is contrary to the plain statutory language and this Court's approach to § 506 in *United Savings Ass'n v. Timbers of Inwood Forest Assocs.*, 484 U.S. 365 (1988), *Dewsnup v. Timm*, 502 U.S. 410 (1992), and *Nobelman v. American Savings Bank*, 508 U.S. 324 (1993). For these reasons, this case merits review by this Court to ensure a uniform interpretation of 11 U.S.C. § 506 (a).

I. THE DECISION BELOW CONFLICTS WITH THE DECISIONS OF OTHER COURTS OF APPEALS AND OF THIS COURT

Amicus adopts this portion of Petitioner's brief by reference thereto, as if copied herein *in extenso.*

II. THE ISSUES HERE PRESENTED ARE OF SUBSTANTIAL ECONOMIC IMPORTANCE

Hibernia National Bank is the largest bank in the state of Louisiana with 199 branches in 29 of 64 parishes (counties). Hibernia's Louisiana markets represent approximately 88% of the state's population and deposits. With the recent amendments to the Bankruptcy Code, Hibernia has seen

the number of Chapter 13 bankruptcy filings increase dramatically. In 1993, Hibernia participated in 182 Chapter 13 bankruptcies, of which 141 involved secured claims, 121 of which were vehicles. In 1994 it handled 163 Chapter 13s which involved 128 secured claims, 114 of which were vehicles. In 1995 Hibernia was involved in 268 Chapter 13s, 196 of which were secured, 163 of which were vehicles. For the first nine months of 1996, the numbers have increased yet again. We have been involved in 536 Chapter 13s, 386 of which were secured involving 325 vehicles.

Most of the Chapter 13s that Hibernia deals with involve vehicles, typically passenger cars and pickup trucks. The difference between the N.A.D.A.[1] retail and wholesale (liquidation) value for these vehicles typically averages between $1200 to $2000 per vehicle. The numbers are higher if a luxury car or truck is involved, usually $2500 to $5000. Probably of even more importance to Hibernia is the fact that if the retail value is used, it is often fully secured, which is important in the number of cases where the debtor has made few, if any payments. Debtors often purchase a brand new vehicle, make no payments, and then "strip down" the value of the vehicle and lien, by using the wholesale number to value the vehicle in their Chapter 13 bankruptcy.

Of equal concern to Hibernia, is that there is no uniform rule among the bankruptcy judges in Louisiana as to how vehicles are to be valued. One judge in the Western District only uses liquidation value. Another judge in the Western District averages the three values listed in the NADA book,

[1] N.A.D.A. Official Used Car Guide, published monthly by the National Automobile Dealers Association.

retail, wholesale and loan to arrive at yet another number. Where the parties cannot agree on value, the judge in the Middle District considers the totality of the circumstances and arrives at a number. The judges in the Eastern District usually use liquidation value. The identical vehicle simply cannot have a far different value solely based upon the district in which the debtor resides. But that is the effect of the en banc *Rash*[2] decision. Thus how secured creditors are treated in the bankruptcy courts in Louisiana is totally dependent on what judge ends up handling the case. There is no uniform rule. Surely Congress did not intend this roulette-like result when it adopted the Chapter 13 provisions.

This Court should grant review of this case and resolve the meaning of 11 USC §506(a) so that there is a uniform rule through out the United States as to valuation of secured collateral retained by a debtor in Chapter 13. Disparate treatment of secured creditors based solely on the district of the debtor's residence should be ended.

[2] *Matter of Rash,* 90 F3d 1036 (5th Cir. 1996)(en banc).

CONCLUSION

The petition for certiorari filed by Associates Commercial Corporation should be granted.

Respectfully submitted

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October 21, 1996

CERTIFICATE OF SERVICE

I hereby certify that a copy of the above and foregoing Motion For Leave To File Amicus Brief and Amicus Brief By Hibernia National Bank In Support Of Petition For A Writ of Certiorari By Associates Commercial Corporation has been served upon Robert Barron, P.O. Box 1347, Nederland Texas 77627, (409) 727-0073 and John J. Durkay, P.O. Box 16, Beaumont, Texas 77704, (409) 835-5011, counsel for Debtors Elray and Jean Rash, Michael Gross, Standing Chapter 13 Trustee, 110 N. College Avenue, Suite 1400, Tyler, Texas 75702, (903) 593-7777, Trustee, Carter G. Phillips, Sidley & Austin, 1722 Eye Street, N.W., Washington, D.C. 20006, (202) 736-8000 and Ben L. Aderholt, 1200 Smith Street, Suite 1400, Houston, Texas 77002, (713) 658-1818, counsel for Associates Commercial Corporation, in the above-captioned proceeding, postage prepaid and properly addressed, this 21st day of October, 1996.

Anita M. Warner

(17)

No. 96-454

IN THE

Supreme Court of the United States

OCTOBER TERM, 1996

ASSOCIATES COMMERCIAL CORPORATION,
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On Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

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Motion for Relief from Stay (Apr. 23, 1992)	56
Objection by Secured Creditor to Confirmation of Plan (May 22, 1992)	60
Transcript of Hearing on (1) Debtor's Objection to Claim of Associates Commercial Corporation, (2) Motion by Associates Commercial Corporation to Prohibit Use of Cash Collateral, (3) Final Hearing on Motion of Associates Commercial Corporation for Relief from Automatic Stay, Before the Honorable Donald R. Sharp, United States Bankruptcy Judge (June 16, 1992)	63
Order denying Associates Commercial Corporation's Motion for Relief from Stay and ordering that Associates' secured claim is $31,875.00 and the remainder of its claim is unsecured (Dec. 31, 1992)	92
First Amended Chapter 13 Plan (Jan. 18, 1993)	93
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The following documents have been reproduced as appendices to the Petition for a Writ of Certiorari and the Plaintiff's Opposition to Respondents' Motion to Dismiss for Mootness:

Opinion, United States Bankruptcy Court, Eastern District Texas, Beaumont Division (Jan. 11, 1993) ....Pet. App. 110a

Panel Opinion, United States Court of Appeals for the Fifth Circuit (Sept. 13, 1994) ....Pet. App. 100a

Panel Opinion, on Petition for Rehearing, United States Court of Appeals for the Fifth Circuit (Aug. 16, 1995) ....Pet. App. 89a

Memorandum Opinion, United States District Court, Eastern District Texas, Beaumont Division (unreported) (Sept. 15, 1993) ....Pet. App. 83a

Opinion, United States Court of Appeals for the Fifth Circuit (en banc) (July 30, 1996) ....Pet. App. 1a

Respondents' Reply to Movants Emergency Motion for Stay of Order Pending Appeal and Request for Expedited Hearing ....Opp. to Mot. to Dismiss App. 1a

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF TEXAS
BEAUMONT DIVISION

Docket No. 92-10305
Chapter 13

IN RE: ELRAY RASH and JEAN RASH,
Debtor.

RELEVANT DOCKET ENTRIES

DATE	NR.	PROCEEDINGS
3/18/92	1	Voluntary Petition And Matrix all schedules and statements. (Filing Fee $120.00 Receipt #49291) (dh) [EOD 03/19/92]
3/18/92	3	Chapter 13 Plan. (dh) [EOD 03/19/92]
4/28/92	6	Response By Debtor Jean E. Rash, Debtor Elray Rash To [5-1] Motion To Lift Stay by Creditor Associates Commercial Corporation. (kh) [EOD 05/04/92]
5/1/92	5	Motion By Creditor Associates Commercial Corporation To Lift Stay. (pm) [EOD 05/01/92]
5/5/92	—	Preliminary Hearing Re: [5-1] Motion To Lift Stay by Creditor Associates Commercial Corporation scheduled For 9:00 5/19/92 at Beaumon District Ctrm, 1st Fl. (mr) [EOD 05/05/92]
5/5/92	7	Certificate of Mailing Re: [0-0] Hearing, [5-1] Motion To Lift Stay by Creditor Associates Commercial Corporation # of notices: 6. (mr) [EOD 05/05/92]

DATE	NR.	PROCEEDINGS
5/14/92	11	Objection By Debtor Jean E. Rash, Debtor Elray Rash To Claim of Associates Commercial Corporation. (pm) [EOD 05/14/92]
5/14/92	12	Notice By Creditor Associates Commercial Corporation To Perfect Interest In Assignments Of Rents. (pm) [EOD 05/14/92]
5/14/92	13	Motion By Creditor Associates Commercial Corporation To Prohibit Use Of Cash Collateral. (pm) [EOD 05/15/92]
5/15/92	—	Hearing Re: [13-1] Motion To Prohibit Use Of Cash Collateral by Creditor Associates Commercial Corporation Scheduled For 9:00 6/16/92 at Beaumont District Ctrm, 1st Fl, [11-1] Claims Objection by Debtor Elray Rash, Jean E. Rash Scheduled For 9:00 6/16/92 at Beaumont District Ctrm, 1st Fl . (st) [EOD 05/15/92]
5/15/92	14	Certificate of Mailing Re: [0-0] Hearing, [13-1] Motion To Prohibit Use Of Cash Collateral by Creditor Associates Commercial Corporation, [11-1] Claims Objection by Debtor Elray Rash, Jean E. Rash # of notices: 37. (st) [EOD 05/15/92]
5/19/92	15	Hearing Held Re: [5-1] Motion To Lift Stay by Creditor Associates Commercial Corporation . Final Hearing on MTLS set for 6/16/92 @ 1:30 in Beaumont, Texas. ASP remains in effect. (mr) [EOD 05/19/92]
5/19/92	—	Final Hearing Re: [5-1] Motion To Lift Stay by Creditor Associates Commercial Corporation scheduled For 1:30 6/16/92 at Beaumont District Ctrm, 1st Fl . (mr) [EOD 05/19/92]
5/22/92	18	Response By Debtor Jean E. Rash, Debtor Elray Rash To [13-1] Motion To Prohibit

DATE	NR.	PROCEEDINGS
		Use Of Cash Collateral by Creditor Associates Commercial Corporation. (pm) [EOD 05/26/92]
5/26/92	19	Objection By Creditor Associates Commercial Corporation To Confirmation Of Plan. (pm) [EOD 05/26/92]
6/16/92	22	Hearing Held Re: [13-1] Motion To Prohibit Use Of Cash Collateral by Creditor Associates Commercial Corporation, [11-1] Claims Objection by Debtor Elray Rash, Jean E. Rash, [5-1] Motion To Lift Stay by Creditor Associates Commercial Corporation. Court combined Final Hearing on MTLS by Associates Commercial Corp. set for 1:30 this date with two matters set for hearing at 9:00; Court took evidence on all matters addressed; Motion to Prohibit Use of Cash Collateral first, Motion denied and order signed in open court; Court took objection to claim and final hearing on MTLS by Associates Commercial Corp. is taken under advisement. Counsel was welcome to submit briefs on those issues. (tn) [EOD 06/18/92]
6/16/92	—	[11-1] Claims Objection by Debtor Elray Rash, Jean E. Rash, [5-1] Motion To Lift Stay by Creditor Associates Commercial Corporation Under Advisement As Of: 6/16/92. (tn) [EOD 06/18/92]
6/17/92	23	Order Denying [13-1] Motion To Prohibit Use Of Cash Collateral by Associates Commercial Corporation . (tn) [EOD 06/18/92]
6/18/92	—	Hearing Re: [21-1] Claims Objection by Debtor Elray Rash, Jean E. Rash scheduled For 10:00 7/22/92 at Beaumont District Ctrm, 1st Fl . (mr) [EOD 06/18/92]

DATE	NR.	PROCEEDINGS
6/18/92	24	Certificate of Mailing Re: [0-0] Hearing, [21-1] Claims Objection by Debtor Elray Rash, Jean E. Rash # of notices: 6. (mr) [EOD 06/19/92]
6/26/92	26	Brief/Memorandum By Creditor Associates Commercial Corporation In Support Of [13-1] Motion To Prohibit Use Of Cash Collateral by Creditor Associates Commercial Corporation (pm) [EOD 06/29/92]
7/17/92	28	Motion By Debtor Jean E. Rash, Debtor Elray Rash To Continue Hearing Re: ([3-1] Chapter 13 Plan) . (tn) [EOD 07/20/92]
7/20/92	29	Brief/Memorandum By Debtor Jean E. Rash, Debtor Elray Rash In Support Of [11-1] Claims Objection by Debtor Elray Rash, Jean E. Rash . (tn) [EOD 07/20/92]
7/20/92	30	Order Granting [28-1] Motion To Continue Hearing Re: ([3-1] Chapter 13 Plan) by Elray Rash, Jean E. Rash Confirmation Hearing Reset To 10:00 8/26/92 At Beaumont District Ctrm, 1st Fl . (tn) [EOD 07/22/92]
7/27/92	33	Certificate Of Notice By Robert E. Barron for Debtor Jean E. Rash, Debtor Elray Rash Re: [30-1] Order Continuing Confirmation Hearing set 8/26/92 in Beaumont at 10:00 a.m.. (pm) [EOD 07/27/92]
9/14/92	—	Confirmation Hearing rescheduled For 9:00 10/28/92 at Beaumont District Ctrm, 1st Fl (pm) [EOD 09/14/92]
9/14/92	35	Certificate Of Notice By Trustee Michael Gross Re: [0-0] Confirmation Hearing. 38 Notices mailed. (pm) [EOD 09/14/92]
9/29/92	36	Motion By Creditor Associates Commercial Corporation For Adequate Protection. (*Deficiency prepared for no proposed Order form

DATE	NR.	PROCEEDINGS
		and Motion does not contain proper objection language.) (pm) [EOD 09/30/92]
10/28/92	—	Hearing Re: [3-1] Chapter 13 Plan Confirmation Hearing Schd For 9:00 1/20/93 At Beaumont District Ctrm, 1st Fl. Continued in open court. (kh) [EOD 10/30/92]
11/12/92	37	Transcript of Hearing Held on 6/16/92. (tn) [EOD 11/12/92]
1/8/93	38	Findings of Fact and Conclusions of Law By Judge Donald R. Sharp Re: [11-1] Claims Objection by Debtor Elray Rash, Jean E. Rash, [5-1] Motion To Lift Stay by Creditor Associates Commercial Corporation. (tn) [EOD 01/11/93]
1/8/93	39	Order Granting [11-1] Claims Objection by Elray Rash, Jean E. Rash, Denying [5-1] Motion To Lift Stay by Associates Commercial Corporation. (tn) [EOD 01/11/93]
1/19/93	40	First Amended [3-1] Chapter 13 Plan Filed By Debtor Jean E. Rash, Debtor Elray Rash. (pm) [EOD 01/19/93]
1/19/93	41	Amended Schedules J And Certificate of Service. (pm) [EOD 01/19/93]
1/20/93	42	Motion By Creditor Associates Commercial Corporation To Continue Hearing Re: ([3-1] Chapter 13 Plan). (pm) [EOD 01/20/93]
1/20/93	43	Motion By Creditor Associates Commercial Corporation to Stay [39-1] Order Denying Associates Commercial Corporations' Motion for Relief from Stay Pending Appeal (pm) [EOD 01/20/93]
1/20/93	44	Notice Of Appeal By Associates Commercial Corporation Appeal Designation Due: 2/1/93 Re: [39-1] Order Denying Associates Com-

DATE	NR.	PROCEEDINGS
		mercial Corporation's Motion for Relief from Stay. (*Letter noticing that Notice of Appeal filed and re: filing of Appellant's Designation sent this date to Robert Barron, P.O. Box 1347, Nederland, TX 77627; Michael Gross, 110 N. College, Ste. 1400, Tyler, TX 75702; Elray and Jean Rash, 716 N. Austin St., Jasper, TX 75951; and U.S. Trustee, 110 N. College, 300 NCNB Tower, Tyler, TX 75702. pm) [EOD 01/20/93] [Edit date 01/20/93]
1/20/93	46	Hearing Held Re: [3-1] First Amended Chapter 13 Plan. Motion for Continuance filed 1/20/93 is Denied. Plan is Confirmed. Order signed. (pm) [EOD 01/21/93]
1/20/93	47	Order Confirming First Amended Chapter 13 Plan. (pm) [EOD 01/21/93]
1/21/93	45	Transcript of Hearing Held on June 16, 1992. (hra) [EOD 01/21/93]
1/25/93	49	Order Denying [42-1] Motion To Continue Hearing Re: ([3-1] Chapter 13 Plan) by Associates Commercial Corporation. (tn) [EOD 01/25/93]
2/1/93	52	Notice Of Appeal By Associates Commercial Corporation Appeal Designation Due: 2/11/93 Re: [47-1] Confirming Chapter 13 Plan Order. Notice of Appeal Letter mailed 2/1/93 to: Ben Aderholt, 1360 Post Oak Blvd. Ste 2300, Houston, TX 77056; Joel P Kay & David McClain, 3700 First City Tower, Houston, TX 77002; Robert Barron, P O Box 1347, PO Box 1347, Nederland, TX 77627; Micheal Gross, 110 North College, Ste 1400, Tyler, TX and the U.S. Trustee, 110 North College, 300 NCNB Tower, Tyler TX. (sl) [EDO 02/01/93]

DATE	NR.	PROCEEDINGS
2/1/93	—	Notice of Appeal Letter mailed 2/1/93 (sl) [EDO 02/01/03]
2/4/93	53	Order Denying [43-1] Motion To Stay [39-1] Order Denying Associates Commercial Corporations' Motion for Relief from Stay Pending Appeal by Associates Commercial Corporation (sl) [EOD 02/05/93]
2/5/93	54	Designation and Statement of Issues By Associates Commercial Corporation Of Contents For Inclusion In Record On Appeal Re: [44-1] Appeal Notice by Creditor Associates Commercial Corporation; (sl) [EOD 02/09/93]
2/8/93	55	Response By Debtor Jean E. Rash, Debtor Elray Rash To [43-1] Motion To Stay [39-1] Order Denying Associates Commercial Corporations' Motion for Relief from Stay Pending Appeal by Creditor Associates Commercial Corporation. (sl) [EOD 02/09/93]
2/10/93	56	Designation and Statement of Issues By Associates Commercial Corporation Of Contents For Inclusion In Record On Appeal Re: [52-1] Appeal Notice by Creditor Associates Commercial Corporation; (sl) [EOD 02/10/93] [Edit date 02/10/93]
2/16/93	57	Appellee's Designation by Jean E. Rash, Elray Rash Of Contents For Inclusion In Record On Appeal Re: [44-1] Appeal Notice by Creditor Associates Commercial Corporation; (sl) [EOD 02/17/93]
2/17/93	58	Designation By Jean E. Rash, Elray Rash Of Contents For Inclusion In Record On Appeal Re: [52-1] Appeal Notice by Creditor Associates Commercial Corporation; (sl) [EOD 02/18/93]

IN THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF TEXAS

No. 1:93-CV-0078

IN RE RASH,
Debtor

ASSOCIATES COMMERCIAL CORPORATION,
Plaintiff

vs.

ELROY AND JEAN RASH,
Defendants.

RELEVANT DOCKET ENTRIES

DATE	NR.	PROCEEDINGS
2/23/93	1	CERTIFICATION of transmittal of record on appeal (bst)
2/23/93	2	Designation by Elray Rash, Jean E Rash of record on appeal (bst)
2/23/93	3	Notice by Associates Commercial Corporation's Designation of Items to be included in record on appeal (bst)
2/23/93	4	Bankruptcy record on appeal received (bst) [Edit date 02/23/93]
2/23/93	5	Notice of docketing bankruptcy record on appeal—appealing Associates Commercial Corporation Appeal Designation Due: 2/1/93 Re: Order Denying Associates Commercial Corporation's Motion for Relief from Stay. Appellant's brief due 3/10/93 for Assoc Commercial (bst) [Edit date 02/23/93]

DATE	NR.	PROCEEDINGS
2/23/93	—	Record on Appeal to Judge Cobb (bst)
5/27/93	7	Brief filed by Assoc Commercial (jel) [Entry date 06/02/93] [Edit date 06/02/93]
6/15/93	9	Appellate Brief filed by Elray Rash, Jean E Rash (bjs) [Entry date 06/18/93]
6/25/93	10	Joint Motion by Assoc Commercial, Elray Rash, Jean E Rash to consolidate cases (bjs) [Entry date 06/28/93]
6/28/93	11	Reply Brief filed by Assoc Commercial (bjs)
8/12/93	12	Order granting [10-1] motion to consolidate cases; that 1:93cv78 and 1:93cv79 are consolidated in 1:93cv78, the style of the case tc remain unchanged. (signed by Judge Howell Cobb) cc attys 8/17/93 (bjs) [Entry date 08/17/93]
9/15/93	14	Memorandum Opinion that the decision of the Bankruptcy Court is Affirmed OB Ref: v242 p127 (signed by Judge Howell Cobb) cc: attys 9-16-93 (fxc) [Entry date 09/16/93]
9/24/93	15	Judgment that the decisions of the Bankruptcy Court are AFFIRMED. OB Ref: v242 p160 (signed by Judge Howell Cobb) cc attys 9/27/93 (bjs) [Entry date 09/27/93]
9/24/93	—	Case closed (bjs) [Entry date 09/27/93]
9/27/93	16	Notice of appeal by Assoc Commercial Fee Status of the memorandum opinion which affirmed the decision of the bankruptcy court: paid $105, receipt 61781 (notice of appeal and docket sheet sent to Fifth Circuit) Appeal record due on 10/27/93 cc: attys 9-27-93 (fxc)
10/1/93	17	Notice of appeal by Assoc Commercial from the final judgment entered 9-24-93 (notice of

DATE	NR.	PROCEEDINGS
		appeal and docket sheet sent to Fifth Circuit) Appeal record due on 11/1/93 (fxc) [Entry date 10/05/93]
10/5/93	—	Notice of Mailing of Document # : 17. cc: attys (fxc)
10/6/93	18	Amended Notice of appeal by Assoc Commercial appealing from the final judgment entered in this cause. (notice of appeal and docket sheet sent to Fifth Circuit) (fxc) [Entry date 10/08/93]
10/20/93	—	Notice of Docketing ROA from USCA Re: [18-1] appeal USCA NUMBER: 93-5396 (bjs)
11/12/93	19	Motion by Assoc Commercial to supplement notice of appeal filed 10/1/93 in order to correct the name of counsel for the debtors (bjs) [Entry date 11/17/93]
11/12/93	—	USCA appeal fee: $105.00 #62827 [18-1] appeal (bjs) [Entry date 11/17/93]

UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 93-5396

ASSOCIATES COMMERCIAL CORPORATION,
Plaintiff

vs.

ELROY AND JEAN RASH,
Defendants.

RELEVANT DOCKET ENTRIES

DATE	PROCEEDINGS
10/14/93	Bankruptcy case docketed. NOA filed by Appellant Assocs Cmercl Corp in 93-5396 . [93-5396] (mrb) [93-5396]
10/14/93	Bankruptcy case docketed. NOA filed by Appellant Assocs Cmercl Corp in 93-5397 . [93-5397] [93-5397]
10/14/93	Additional Appeal docketed. [93-5396, 93-5397] (mrb) [93-5396 93-5397]
10/14/93	Bankruptcy case docketed. NOA filed by Appellant Assocs Cmercl Corp in 93-5398 . [93-5398] (mrb) [93-5398]
10/14/93	Additional Appeal docketed. [93-5396, 93-5397, 93-5398] (mrb) [93-5396 93-5397 93-5398]
12/10/93	Record on appeal filed. Volumes: 4 . [93-5396, 93-5397, 93-5398] (mrb) [93-5396 93-5397 93-5398]
1/31/94	Appellant's Brief filed by Appellant Assocs Cmercl Corp in 93-5396, Appellant Assocs Cmercl Corp in 93-5397, Appellant Assocs Cmercl Corp in 93-

DATE	PROCEEDINGS
	5398 . Copies of brief: 7 # of pages: 37. Sufficient [Y/N]: y . [93-5396, 93-5397, 93-5398] A/Pet's Brief ddl satisfied. E/Res's Brief due on 3/2/94 for Jean E Rash in 93-5396, for Elray Rash in 93-5396, for Jean E Rash in 93-5397, for Elray Rash in 93-5397, for Jean E Rash in 93-5398, for Elray Rash in 93-5398 . (mrb) [93-5396 93-5397 93-5398]
2/3/94	Record excerpts filed by Appellant Assocs Cmercl Corp in 93-5396, Appellant Assocs Cmercl Corp in 93-5397, Appellant Assocs Cmercl Corp in 93-5398 # of copies: 4 Sufficient [Y/N]: y . [93-5396, 93-5397, 93-5398] (mrb) [93-5396 93-5397 93-5398]
2/28/94	Brief filed by Appellee Elray Rash in 93-5396, Appellee Jean E Rash in 93-5396, Appellee Elray Rash in 93-5397, Appellee Jean E Rash in 93-5397, Appellee Elray Rash in 93-5398, Appellee Jean E Rash in 93-5398. Copies of Brief: 7 # of pages: 34. Sufficient [Y/N]: y. .[93-5396, 93-5397, 93-5398] E/Res's Brief ddl satisfied. Reply Brief due on 3/14/94 for Assocs Cmercl Corp in 93-5396, for Assocs Cmercl Corp in 93-5397, for Assocs Cmercl Corp in 93-5398. (mrb) [93-5396 93-5397 93-5398]
3/28/94	Reply brief filed by Appellant Cmercl Corp in 93-5396, Appellant Assocs Cmercl Corp in 93-5397, Appellant Assocs Cmercl Corp in 93-5398. Copies of Brief: 7 # of pages: 5. Sufficient [Y/N]: y.. [93-5396, 93-5397, 93-5398] Reply Brief ddl satisfied. (mrb) [93-5396 93-5397 93-5398]
6/24/94	Case calendared for oral argument. [93-5396, 93-5397, 93-5398] (gam) [93-5396 93-5397 93-5398]
9/13/94	Opinion filed. If published # of pages: 6 Issue Mandate due on 10/4/94 in 93-5396, in 93-5397, in 93-5398 . [93-5396, 93-5397, 93-5398] (dmt) [93-5396 93-5397 93-5398]

DATE	PROCEEDINGS
9/13/94	Judgment entered and filed. [93-5396, 93-5397, 93-5398] (dmt) [93-5396 93-5397 93-5398]
9/23/94	Petition filed by Appellee Elray Rash in 93-5396, Appellee Jean E Rash in 93-5396, Appellee Elray Rash in 93-5397, Appellee Jean E Rash in 93-5397, Appellee Elray Rash in 93-5398, Appellee Jean E Rash in 93-5398 for rehearing. # of copies filed: 4 [143601-1] Issue Mandate ddl canceled. [93-5396, 93-5397, 93-5398] (mrb) [93-5396 93-5397 93-5398]
9/27/94	Suggestion filed by Appellee Elray Rash in 93-5396, Appellee Jean E Rash in 93-5396, Appellee Elray Rash in 93-5397, Appellee Jean E Rash in 93-5397, Appellee Elray Rash in 93-5398, Appellee Jean E Rash in 93-5398 for rehearing en banc. # of copies filed: 20 [143664-1] [93-5396, 93-5397, 93-5398] (mrb) [93-5396 93-5397 93-5398]
10/14/94	Response/opposition filed by Appellant Assocs Cmercl Corp in 93-5396, Appellant Assocs Cmercl Corp in 93-5397, Appellant Assocs Cmercl Corp in 93-5398 to petition for rehearing [143601-1] by Appellee by Elray Rash, Appellee, Jean E Rash, Appellee, Elray Rash, Appellee, Jean E Rash, Appellee, Elray Rash, Appellee, Jean E Rash in 93-5396, petition for rehearing [143601-1] by Appellee by Elray Rash, Appellee, Jean E Rash, Appellee, Elray Rash, Appellee, Jean E Rash, Appellee, Elray Rash, Appellee, Jean E Rash in 93-5397, petition for rehearing [143601-1] by Appellee by Elray Rash, Appellee, Jean E Rash, Appellee, Elray Rash, Appellee, Jean E Rash, Appellee, Elray Rash, Appellee, Jean E Rash in 93-5398 [144070-1] [93-5396, 93-5397, 93-5398] (mrb) [93-5396 93-5397 93-5398]
10/14/94	Response/opposition filed by Appellant Assocs Cmercl Corp in 93-5396, Appellant Assocs Cmercl

DATE	PROCEEDINGS
	Corp in 93-5397, Appellant Assocs Cmercl Corp in 93-5398 to suggestion for rehearing en banc [143664-1] by Appellee by Elray Rash, Appellee, Jean E Rash, Appellee, Elray Rash, Appellee, Jean E Rash, Appellee, Elray Rash, Appellee, Jean E Rash in 93-5396, suggestion for rehearing en banc [143664-1] by Appellee by Elray Rash, Appellee, Jean E Rash, Appellee, Elray Rash, Appellee, Jean E Rash in 93-5397, suggestion for rehearing en banc [143664-1] by Appellee by Elray Rash, Appellee, Jean E Rash, Appellee, Elray Rash, Appellee, Jean E Rash, Appellee, Elray Rash, Appellee, Jean E Rash in 93-5398 [144075-1] [93-5396, 93-5397, 93-5398] (mrb) [93-5396 93-5397 93-5398]
8/16/95	COURT Order filed (PUBLISHED) denying petition for rehearing [143601-1] in 93-5396, denying petition for rehearing [143601-1] in 93-5397, denying petition for rehearing [143601-1] in 93-5398 (JES) (RMP—DISSENTING) Copies to all counsel. [93-5396, 93-5397, 93-5398] (mrb) [93-5396 93-5397 93-5398]
10/18/95	COURT Order filed granting suggestion for rehearing en banc [143664-1] with Argument (Y/N)? y Before: All active judges (except Judges Garwood, Higginbotham and Jones, who are recused) and Judge Reynaldo G. Garza. A/Pet Supplemental Brief due on 11/17/95 for Assocs Cmercl Corp 93-5396, for Assocs Cmercl Corp in 93-5397, for Assocs Cmercl Corp in 93-5398. E/Res Supplemental Brief due on 12/18/95 for Jean E Rash in 93-5396, for Elray Rash in 93-5396, for Jean E Rash in 93-5397, for Elray Rash in 93-5397, for Jean E Rash in 93-5398, for Elray Rash in 93-5398. Amicus Brief due on 12/4/95 for Natl Assoc Consum Bn in 93-5396, for NationsBank Corp in 93-5396, for Mercedes-Benz Credit in 93-5396, for Natl Assoc Consum Bn in 93-5397, for

DATE	PROCEEDINGS
	NationsBank Corp in 93-5397, for Mercedes-Benz Credit in 93-5397, for Natl Assoc Consum Bn in 93-5398, for NationsBank Corp in 93-5398, for Mercedes-Benz Credit in 93-5398 in 93-5396, 93-5397, 93-5398 () Copies to all counsel. [93-5398 in 93-5396, 93-5397, 93-5398] (jmg) [93-5396 93-5397 93-5398]
10/18/95	Case reopened. [93-5396, 93-5397, 93-5398] (jmg) [93-5396 93-5397 93-5398]
11/3/95	Case tentatively calendared for En Banc oral argument Week of: 01/15/96. [93-5396, 93-5397, 93-5398] (gam) [93-5396 93-5397 93-5398]
11/17/95	Supplemental brief filed by Appellant Assocs Cmercl Corp in 93-5396, Appellant Assocs Cmercl Corp in 93-5397, Appellant Assocs Cmercl Corp in 93-5398. Copies of Brief: 20 # of pages: 43. [93-5396, 93-5397, 93-5398] A/Pet Supplemental Brief ddl satisfied. (mrb) [93-5396 93-5397 93-5398]
11/30/95	Case calendared for oral argument. [93-5396, 93-5397, 93-5398] (gam) [93-5395 93-5397 93-5398]
12/18/95	Supplemental brief filed by Appellee Jean E Rash in 93-5396, Appellee Elray Rash in 93-5396, Appellee Jean E Rash in 93-5397, Appellee Elray Rash in 93-5397, Appellee Jean E Rash in 93-5398, Appellee Elray Rash in 93-5398 Copies of Brief: 21 # of pages: 45. [93-5396, 93-5397, 93-5398] E/Res Supplemental Brief ddl satisfied. (mrb) [93-5396 93-5397 93-5398]
12/20/95	CLERK Order filed granting motion for reconsideration [182391-1] in 93-5396, granting motion for reconsideration [182391-1] in 93-5397, granting motion for reconsideration [182391-1] in 93-5398 Copies to all counsel. [93-5396, 93-5397, 93-5398] The brief of the Association of International Automobile Manufacturers, Inc and Amer-

DATE	PROCEEDINGS
	ican Financial Services will be filed as amici curiae. (mrb) [93-5396 93-5397 93-5398]
1/16/96	Oral argument heard. Case argued by Pamela Arnold Bassel for Amicus Curiae Bank of America TX, Amicus Curiae Hibernia Natl Bank, Amicus Curiae NationsBank Corp in 93-5396, Ben L Aderholt for Appellant Assocs Cmercl Corp in 93-5396, John J Durkay for Appellee Elray Rash, Appellee Jean E Rash in 93-5396, Norma Lorraine Hammes for Amicus Curiae Natl Assoc Consum Bn in 93-5396, [93-5396, 93-5397 93-5398] (sme) [93-5396 93-5397 93-538]
7/30/96	Opinion filed. Issd in T form? y Issue Mandate due on 8/20/96 in 93-5396, in 93-5397, in 93-5398 . [93-5396, 93-5397, 93-5398] (rmf) [93-5396 93-5397 93-5398]
7/30/96	Judgment entered and filed. [93-5396, 93-5397, 93-5398] (rmf) [93-5396 93-5397 93-5398]
8/29/96	Mandate issued. Approved BOC Issued (Y/N)?: n [93-5396, 93-5397, 93-5398] Issue Mandate ddl satisfied. (lew) [93-5396 93-5397 93-5398]
9/5/96	Motion filed by Appellant Assocs Cmercl Corp in 93-5396, Appellant Assocs Cmercl Corp in 93-5397, Appellant Assocs Cmercl Corp in 93-5398 to recall and stay the mandate pending certiorari. [409294-1] Response/Opposition due on 9/17/96. 93-5396, in 93-5397, in 93-5398 . [93-5396, 93-5397, 93-5398] (van) [93-5396 93-5397 93-5398]
9/10/96	Response/Opposition filed by Appellee Jean E Rash in 93-5396, Appellee Elray Rash in 93-5396, Appellee Jean E Rash in 93-5397, Appellee Elray Rash in 93-5397, Appellee Jean E Rash in 93-5398, Appellee Elray Rash in 93-5398 to motion to recall the mandate [409294-1] by Appellant Assocs Cmercl Corp, in 93-5396, motion to recall the mandate [409294-1] by Appellant Assocs Cmercl Corp,

DATE	PROCEEDINGS
	in 93-5397, motion to recall the mandate [409294-1] by Appellant Assocs Cmercl Corp, in 93-5398 [412725-1] [93-5396, 93-5397, 93-5398] (mrb) [93-5396 93-5397 93-5398]
9/12/96	Reply filed by Appellant Assocs Cmercl Corp in 93-5396, Appellant Assocs Cmercl Corp in 93-5397, Appellant Assocs Cmercl Corp in 93-5398 to response/opposition [412725-1] by Appellee Jean E Rash,, Appellee Elray Rash in 93-5396, response/opposition [412725-1] by Appellee Jean E Rash, , Appellee Elray Rash in, 93-5397 response/opposition [412725-1] by Appellee Jean E Rash, Appellee Elray Rash in 93-5398 [412746-1] [93-5396, 93-5397, 93-5398] (mrb) [93-5396 93-5397 93-5398]
9/27/96	COURT Order filed denying motion to recall the mandate [409294-1] in 93-5396, denying motion to recall the mandate [409294-1] in 93-5397, denying motion to recall the mandate [409294-1] in 93-5398 (CDK) Copies to all counsel. [93-5396, 93-5397, 93-5398] (mrb) [93-5396 93-5397 93-5398]
10/1/96	Supreme Court notice that petition for certiorari was filed on 09/23/96. Supct. No.: 96-454 (mrb) [93-5396 93-5397 93-5398]
104/96	Record on appeal returned to USDC. Volumes: 4 . [93-5396, 93-5397, 93-5398] (mrb) [93-5396 93-5397 93-5398]

UNITED STATES BANKRUPTCY COURT EASTERN DISTRICT OF TEXAS BEAUMONT DIVISION	VOLUNTARY PETITION
IN RE *Rash, Elray*	NAME OF JOINT DEBTOR *Jean E. Rash*
ALL OTHER NAMES used by the debtor in the last 6 years	ALL OTHER NAMES used by the joint debtor in the last 6 years
SOC. SEC.#/TAX I.D.# *453-62-4181*	SOC. SEC.#/TAX I.D.# *449-92-7668*
STREET ADDRESS OF DEBTOR *716 N. Austin Street* *Jasper, TX 75951* COUNTY OF RESIDENCE OR BUSINESS *Jasper*	STREET ADDRESS OF JOINT DEBTOR *716 N. Austin Street* *Jasper, TX 75951* COUNTY OF RESIDENCE OR BUSINESS *Jasper*
MAILING ADDRESS OF DEBTOR	MAILING ADDRESS OF JOINT DEBTOR
BUSINESS DEBTOR'S PRINCIPAL ASSET LOCATION	VENUE [X] *Debtor's domicile, residence, or business assets are in this District.*

INFORMATION REGARDING DEBTOR

DEBTOR TYPE: [X] *Joint (Husband & Wife)* DEBT NATURE: [X] *Non-Business/Consumer*	CHAPTER/SECTION: [X] *Chapter 13* FILING FEE: [X] *attached*
	NAME AND ADDRESS OF LAW FIRM OR ATTORNEY *Robert E. Barron, P.C.* *TBA No. 01820800* *P. O. Box 1347* *Nederland, TX 77627* Telephone No. *(409) 727-0073*
	ATTORNEY(S) REPRESENTING DEBTOR *Robert E. Barron, P.C.* 92-10305S
	[ ] *Debtor not represented by an attorney.*

STATISTICAL ADMINISTRATIVE INFORMATION (28 U.S.C. 604)	THIS SPACE FOR COURT USE ONLY
[X] *Funds will be available for unsecured creditors.*	
ESTIMATED NO. OF CREDITORS: [X] *16-49* ESTIMATED ASSETS (thousands): [X] *50-99* ESTIMATED LIABILITIES (thousands): [X] *50-99* ESTIMATED NO. OF EMPLOYEES: [X] *Not Applicable* ESTIMATED EQUITY SECURITY HOLDERS: [X] *Not Applicable*	

(8)

No. 96-454

IN THE

Supreme Court of the United States

OCTOBER TERM, 1996

ASSOCIATES COMMERCIAL CORPORATION,
Petitioner,

v.

ELRAY RASH and JEAN E. RASH,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

BRIEF OF PETITIONER

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QUESTION PRESENTED

Whether, when a debtor proposes to retain a secured creditor's collateral under the cramdown powers of chapter 13 of the Bankruptcy Code, the amount required to be paid on account of the creditor's secured claim is limited to the value that the secured creditor could have obtained if it had sold the collateral at foreclosure.

LIST OF PARTIES AND RULE 29.6 STATEMENT

There are none other than the named parties herein. Petitioner is an 80%-owned subsidiary of Ford Motor Corporation.

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IN THE

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OCTOBER TERM, 1996

No. 96-454

ASSOCIATES COMMERCIAL CORPORATION,
Petitioner,
v.
ELRAY RASH and JEAN E. RASH,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

BRIEF OF PETITIONER

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Fifth Circuit sitting *en banc* is reported at 90 F.3d 1036. The original panel opinion of the Fifth Circuit is reported at 31 F.3d 325. The panel's modified opinion is reported at 62 F.3d 685. The opinion of the United States District Court for the Eastern District of Texas has not been reported; it is included in the Appendix to the Petition for a Writ of Certiorari ("Pet. App.") at 83a-88a. The opinion of the United States Bankruptcy Court for the Eastern District of Texas is reported at 149 B.R. 430.

JURISDICTION

This Court has jurisdiction pursuant to 28 U.S.C. § 1254(1). The judgment of the court of appeals was

entered on July 30, 1996. The petition for a writ of certiorari was docketed on September 24, 1996, and granted on January 17, 1997.

STATUTORY PROVISIONS INVOLVED

11 U.S.C. § 1325 provides as follows: [1]

§ 1325. Confirmation of Plan

(a) Except as provided in subsection (b), the court shall confirm a plan if—

* * * *

(5) with respect to each allowed secured claim provided for by the plan—

(A) the holder of such claim has accepted the plan;

(B)(i) the plan provides that the holder of such claim retain the lien securing such claim; and

(ii) the value, as of the effective date of the plan, of property to be distributed under the plan on account of such claim is not less than the allowed amount of such claim; or

(C) the debtor surrenders the property securing such claim to such holder. . . .[2]

11 U.S.C. § 506 provides as follows:

§ 506. Determination of Secured Status

(a) An allowed claim of a creditor secured by a lien on property in which the estate has an interest,

[1] All statutory citations are to the Bankruptcy Code (11 U.S.C.), unless otherwise indicated. The numbering of sections in the Bankruptcy Code is the same as the numbering in Title 11 of the United States Code.

[2] The chapter 12 provision, § 1225(a)(5), is essentially identical to § 1325(a)(5). The chapter 11 provision, § 1129(b)(2)(A)(i), is similar.

or that is subject to setoff under section 553 of this title, is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property, or to the extent of the amount subject to setoff, as the case may be, and is an unsecured claim to the extent that the value of such creditor's interest or the amount so subject to setoff is less than the amount of such allowed claim. Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor's interest.

STATEMENT OF THE CASE

Respondent Elray Rash has a freight-hauling business. He derives his income from a Kenworth T600A tractor truck. Rash bought a new truck in 1989 for $73,700, and financed its cost (less trade-in) from the dealer, agreeing to pay $1,610 a month for 60 months and pledging the truck as collateral. The dealer assigned the secured loan to petitioner Associates Commercial Corporation ("Associates"), which holds a valid lien on the truck to secure Rash's payment obligations.

In early 1992, Associates agreed to reschedule the truck loan, lowering the monthly payments from $1,610 to $1,408. Pet. App. 101a. This relief was not sufficient to solve Rash's financial difficulties, so in March 1992, he and his wife, respondent Jean Rash, filed a joint petition for bankruptcy, and proposed a payment plan under chapter 13 of the Bankruptcy Code.

At the time of the bankruptcy filing, the balance due to Associates on the truck loan was $41,171. In their plan, the Rashes valued the truck at only $28,500 and proposed a "cram down" of Associates' secured claim pursuant to § 1325(a)(5)(B) of the Code. Specifically, the plan proposed that respondents would keep the truck, and Associates would be allowed a secured claim of only $28,500. The balance of Associates' debt would be treated

as an unsecured claim. The plan, as ultimately confirmed, contemplated that unsecured creditors would receive only about 15 cents on the dollar—and those payments would not be made for several years. *Id.* at 38a n.24.

Associates asked the bankruptcy court to lift the automatic stay so that it could repossess the truck. Associates also filed a proof of claim which asserted that the entire $41,171 debt was secured. Respondents objected to the claim, saying the truck was worth only $28,500, and therefore Associates' secured claim was limited to this amount. Respondents neither disputed that they owed $41,171 nor challenged the validity of Associates' lien on the truck. *Id.* at 3a.

At the hearing on these matters, there was no real dispute about the retail or replacement value of the truck to respondents. Associates' expert witness testified that the truck's "current market value"—which he defined as the fair value that a person walking in off the street would pay to a dealer—was $41,000. *Id.* at 3a-4a. Respondents' expert witness similarly testified that the truck's retail value was $42,500, a figure he derived from the industry blue book. Nevertheless, he stated that the "value" of the truck was what a dealer would pay—*i.e.*, wholesale value—which he calculated by deducting 25% from his estimate of the retail value, arriving at a figure of $31,875. *Id.* at 4a. In short, as the bankruptcy court noted, "[b]oth experts agreed as to the retail value of the truck; they just disagreed as to whether the retail or wholesale value should be used." *Id.* at 102a.

The sole issue decided by the bankruptcy court was the appropriate standard for valuing the truck as collateral. The bankruptcy court framed the issue as follows:

> Associates maintains that the truck should be valued according to its retail value i.e. what the Debtor would be required to pay to replace it. Debtor disagrees, arguing that the appropriate standard of valuation should be the wholesale value of the truck i.e. what the truck is worth to the dealer. . . . The outcome of this issue will decide how Associates' claim is treated in Debtor's plan.

Pet. App. 111a.

The bankruptcy court viewed the issue before it as a pure question of law—whether retail value or wholesale value is the appropriate standard of valuation when a debtor proposes to "cram down" a plan over a secured creditor's objection. The court concluded that under § 506(a), "value is defined from the creditor's perspective: How much would the creditor realize upon repossession and disposition of the collateral . . . ?" *Id.* at 118a. Based on this interpretation of the statute, the bankruptcy court adopted a wholesale valuation. *Id.* at 118a-119a n.3. Then, after valuing the truck at $31,875, the bankruptcy court denied Associates' motion to lift the automatic stay. Although the court acknowledged that Rash "does not have any equity in the truck," it found that "Debtor has demonstrated the necessity of the truck for" a successful reorganization. *Id.* at 119a.

In response to the bankruptcy court's finding, the Rashes amended their plan to allow Associates a secured claim of $31,875, to be paid over 58 months (with interest at nine percent) . The amended plan was then confirmed over Associates' objection. As a result, the Rashes' payment obligation on the secured claim was reduced to $31,875, rather than the entire loan balance of $41,171. By paying that amount they could discharge Associates' security interest and retain a truck worth $42,500 to them. The Rashes are leasing the truck to a third party for approximately $1,200 per week, while paying Associates about $158 per week under the plan. Pet. App. 87a.

Associates timely appealed the final order approving confirmation of the chapter 13 plan, as well as the order denying relief from the stay to the United States District

Court for the Eastern District of Texas. Exercising jurisdiction under 28 U.S.C. §§ 157 and 1334, that court affirmed. Pet. App. 88a.

A panel of the court of appeals reversed. Pet. App. 100a-109a. The panel concluded that the valuation of the truck should not be based on what Associates could obtain by foreclosing, but on the use contemplated under the Rashes' plan. Because the plan prevented Associates from foreclosing on the truck, but instead allowed the debtors to continue using the collateral, the panel found that the appropriate value was the "value to the debtor of retaining and using the property," which "can best be measured by what he would have to pay to purchase another truck." Pet. App. 105a-106a.

A petition for rehearing *en banc* was granted. While that petition was pending, the First, Eighth and Ninth Circuits issued decisions agreeing with the panel below. Nevertheless, by a vote of 9-6 (with Judges Jones, Higginbotham and Garwood recused), the *en banc* court overturned the panel decision, rejected the holdings of the other circuits, and held that petitioner's secured claim was limited to the foreclosure value of its collateral. Pet. App. 1a-51a. The majority ruled that "[u]ltimately, it is the creditor's interest that is being valued under § 506(a), and such valuation must account for the fact that the creditor's interest is in the nature of a security interest, giving the creditor the right to repossess and sell the collateral and nothing more. Therefore, the valuation should start with what the creditor could realize by exercising that right." Pet. App. 14a.

SUMMARY OF ARGUMENT

1. In Section 506 of the Bankruptcy Act, Congress established and defined the rights of secured creditors in bankruptcy when the value of the secured property is worth less than the debt. The statute plainly grants the creditor a secured claim equal to the value of the collateral and then the provision mandates that this "value shall be determined in light of the purpose of the valuation and of the proposed disposition *or* use of such property . . . ." 11 U.S.C. § 506(a) (emphasis added). Under the ruling below the conjunctive "or" is rendered a nullity because the valuation is identical whether the property is disposed of or used by the debtor. Only by recognizing that the valuation differs depending upon whether the property is relinquished by the debtor or kept for his or her personal use is the "disposition or use" language given full effect as required by traditional rules of statutory construction. See *United States* v. *Nordic Village, Inc.*, 503 U.S. 30, 36 (1992).

The suggestion that the value of the collateral should always be understood as involving "foreclosure" value is inconsistent with this Court's analysis of the term value in *BFP* v. *Resolution Trust Corp.*, 511 U.S. 531 (1994). In *BFP* both the majority and dissent agreed that the unadorned term value does not mean foreclosure value. Thus, if Congress had intended a liquidation standard, it would not have used the term "value" and it would not have insisted that valuation be performed in light of "disposition or use." Congress knows all too well how to limit creditor's interests to liquidation values.

Under petitioner's proposed approach, the inquiry is quite simple. The court must take into account the debtor's choice to retain and use the collateral. The court then "values" the property in light of this use by asking how much is the fair market value of this particular piece of property if the debtor replaced it by purchasing it from a willing seller. Under that legal standard, it is clear that the Rashes would have paid $41,000 to obtain the tractor truck they chose to retain as their primary income for funding their chapter 13 plan.

2. The key to the court of appeals' holding is its reliance upon principles of federalism to require petitioner to

demonstrate that its interpretation is "clearly" supported by the language of the statute. But the court of appeals' methodology is fundamentally wrong because it is the court's expansion of the debtor's rights that does harm to principles of federalism.

The argument of the court below fundamentally confuses rights and remedies. Under state law, petitioner is entitled to full payment. It is only the intervention of bankruptcy that modifies that right. That limitation on the creditor's rights, however, should be strictly limited unless Congress has expressed an unmistakable intent further to restrict the creditors' rights, which Congress has not done.

In any event, this is not a case like *BFP* where the statute essentially is silent on the proper approach and the court looks to state law to provide a backdrop for defining the parties' rights. Here, Congress has spoken plainly that the debtor's decision to "use" the property must be considered by the courts in valuing the creditor's secured interest. That statutory mandate, by itself, resolves this case in petitioner's favor.

Petitioner's interpretation of § 506(a) constitutes a reasonable accommodation of the relevant interests of the parties to the bankruptcy. To be sure, the secured creditor is afforded somewhat greater protection, but that simply reflects the greater risk that the secured creditor assumes by not being able to repossess the collateral. That certainly is a fair exchange for having a plan crammed down over the creditor's objection. As for the unsecured creditors, they cannot reasonably expect to receive anything more or less than they would obtain in a chapter 7 liquidation. With regard to the debtor, he or she is permitted to keep the property and in this case to use it as the primary basis for funding the chapter 13 plan.

3. The Seventh Circuit's novel approach should be rejected. *In re Hoskins*, 102 F.3d 311 (7th Cir. 1996). Finding the language of the statute unhelpful, that court turned to economic principles to determine what a hypothetical creditor and debtor would do to resolve this problem. According to the court, they would split the difference and thus that is the approach mandated by that court.

There is simply no basis for abandoning the traditional methods of statutory construction in this case. The language and structure of the statute do provide an answer: the secured interest should be measured by the amount the debtor would pay to replace the collateral thereby reflecting the debtor's choice to "use" rather than dispose of the property. If a "split the difference" solution is in some sense preferable to the approach currently embodied in § 506(a), then that is obviously a matter for Congress not this Court.

ARGUMENT

The issue presented in this case is the proper measure for valuing a secured creditor's claim when the debtor proposes to retain the collateral and use it as part of a chapter 13 plan. The *en banc* decision below stands alone in concluding that the wholesale value—or what the secured creditor might receive on foreclosure—is the appropriate measure. On the other side, five circuits have concluded that when the debtor proposes to use the collateral, its value should be determined by reference to that use—or what the debtor would have to pay for similar property of like character and condition. *Taffi* v. *United States* (*In re Taffi*), 96 F.3d 1190, 1192 (9th Cir. 1996) (*en banc*), *petition for cert. filed* (U.S. Oct. 31, 1996) (No. 96-881); *Metrobank* v. *Trimble* (*In re Trimble*), 50 F.3d 530, 531-32 (8th Cir. 1995); *Winthrop Old Farm Nurseries, Inc.* v. *New Bedford Inst. for Sav.* (*In re Winthrop Old Farm Nurseries, Inc.*), 50 F.3d 72, 74-75 (1st Cir. 1995); *Huntington Nat'l Bank* v. *Pees*

(*In re McClurkin*), 31 F.3d 401, 404 (6th Cir. 1994); *Coker* v. *Sovran Equity Mortgage Co.* (*In re Coker*), 973 F.2d 258, 260 (4th Cir. 1992). Sometimes this standard is expressed in terms of "retail value," *e.g.*, *In re Trimble*, 50 F.3d at 532, and sometimes it is expressed in terms of "fair market value." *In re Taffi*, 96 F.3d 1190. In either case, the valuation reflects what the debtor would have to pay for a comparable asset outside of bankruptcy, and is dramatically different from the liquidation valuation adopted by the majority below.

Most recently, two circuits have essentially split the difference by adopting yet another rule—"the average of retail and wholesale value of the collateral." *In re Hoskins*, 102 F.3d 311, 316 (7th Cir. 1996); *General Motors Acceptance Corp.* v. *Valenti* (*In re Valenti*), 1997 WL 31577, at *1 (2d Cir. Jan. 15, 1997) (approving a local bankruptcy rule requiring "the average of trade-in and retail values" in the applicable Official Used Car guide "[u]nless otherwise determined by the court"). This rule, albeit incorrect, also conflicts with the ruling below.

For the reasons set forth hereafter, both the liquidation value approach adopted by the Fifth Circuit and the "split the difference" rule of the Seventh and Second Circuits are contrary to the language and structure of the Bankruptcy Code and are inconsistent with the prior decisions of this Court. The correct measure is the replacement or retail value of the collateral—what the debtor would have to pay for similar property.

I. THE BANKRUPTCY CODE REQUIRES A REPLACEMENT VALUATION OF COLLATERAL THAT THE DEBTOR PROPOSES TO RETAIN AND USE IN A BANKRUPTCY REORGANIZATION UNDER CHAPTER 13.

A. The Plain Meaning of Section 506(a) Supports Petitioner's Interpretation of the Statute.

Section 506 of the Code establishes the claims of secured creditors. Subsection (a) defines the claims of *under*-

secured creditors—that is, it applies when the debtor has no equity in the collateral because the collateral is worth less than the debt. In these circumstances, § 506(a) " 'requires a bifurcation of a "partially secured" or "undersecured" claim into separate and independent secured claim and unsecured claim components." *United States* v. *Ron Pair Enters., Inc.*, 489 U.S. 235, 239 n.3 (1989) (quoting 3 *Collier on Bankruptcy* ¶ 506.04, at 506-15 (15th ed. 1988)).

Section 506(a) has two sentences. The first provides that the creditor has a secured claim equal to the value of the collateral and that the balance of the allowed claim is unsecured:

> An allowed claim of a creditor secured by a lien on property in which the estate has an interest . . . is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property, . . . and is an unsecured claim to the extent that the value of such creditor's interest . . . is less than the amount of such allowed claim.

That sentence says nothing about *how* to value the collateral; it only specifies that it is the collateral that must be valued. As this Court has noted: "The phrase 'value of such creditor's interest' in § 506(a) means 'the value of the collateral.' " *United Sav. Ass'n* v. *Timbers of Inwood Forest Assocs.*, 484 U.S. 365, 372 (1988) (citation omitted). See *infra* pp. 31-33.

It is the second sentence of § 506(a) that tells bankruptcy courts *how* to value the collateral:

> Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor's interest.

To be sure, this language does not purport to establish a fixed mathematical formula for valuation. But, if it is

to mean anything at all, it must be read to give significance to both "the purpose of the valuation" and "the proposed disposition *or* use of such property" in deciding how the collateral should be valued. Otherwise, there would be no point for Congress to specify that "value shall be determined" in light of those factors.

Under the Fifth Circuit's holding, however, a liquidation measure of value is *always* used, regardless of the "proposed disposition or use" of the collateral and regardless of the "purpose of the valuation." This interpretation must be rejected because it fails the common-sense requirement that "a statute must, if possible, be construed in such fashion that every word has some operative effect." *United States v. Nordic Village, Inc.*, 503 U.S. 30, 36 (1992).[8] Other courts have rightly rejected this interpretation of § 506(a) because it does not "'give effect, if possible, to every word Congress used.'" *Coker* v. *Sovran Equity Mortgage Co.* (*In re Coker*), 973 F.2d 258, 260 (4th Cir. 1992) (quoting *Reiter* v. *Sonotone Corp.*, 442 U.S. 330, 339 (1979)). "'If the first sentence of § 506(a) were interpreted to mean that the value must be fixed at the amount which the creditor would receive on foreclosure, then the last sentence of the statute which provides that the value should be determined in light of the purpose of the valuation and of the proposed disposition or use of the property, would be surplusage.'" *Metrobank* v. *Trimble* (*In re Trimble*), 50 F.3d 530, 531 (8th Cir. 1995) (citations omitted).

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[8] As this Court stated, in another case involving the interplay of § 506 and chapter 13:

> We generally avoid construing one provision in a statute so as to suspend or supersede another provision. To avoid deny-[ing] effect to a part of a statute, we accord significance and effect . . . to every word.

Rake v. *Wade*, 508 U.S. 464, 471 (1993) (internal quotation marks and citations omitted) (Court's brackets and ellipses).

B. The Measure of Value Must Reflect the "Proposed Disposition or Use" of the Collateral, and That Supports Valuing the Collateral as if the Debtor Had to Purchase It Elsewhere.

The most telling clause in § 506(a), for purposes of this case, is its directive that valuation reflect "the proposed disposition or use" of the collateral. The language embodies two ideas, both of which were ignored by the majority below. The first is that the valuation must reflect the use of the collateral that is proposed under the plan rather than some alternative hypothetical use or disposition that the plan does not propose. The second is that there must be a clear distinction for valuation purposes between a "proposed disposition" and a "proposed . . . use" of property. Thus, where a plan proposes to surrender the collateral to the secured creditor pursuant to § 1325(a)(5)(C), that would be a "proposed disposition," and the value of the secured claim (for purposes of determining the amount of the unsecured deficiency) would appropriately be measured by the value of the collateral to the creditor. Similarly, where the collateral is to be sold at auction, the value of the secured claim would be the auction or liquidation value. On the other hand, where a plan proposes a "use" of collateral by a debtor, the statute directs that the valuation be based on this use—and that equates to what the debtor would pay to purchase comparable property elsewhere.

The Rashes' plan did not propose the "disposition" of the truck collateral pledged to Associates. Instead, the plan specified that the Rashes would retain the truck and use it to generate future income. This is a "use" by the debtor—and the only way to read the statute coherently is to value the truck in accordance with that proposed use, which must mean something different from the value of the property if the Rashes had disposed of it. Nonetheless, the majority below treated the "proposed . . . use" by the debtor as irrelevant, and instead valued the collateral based on a theoretical "disposition" by Associates,

which the plan did not propose. This interpretation mistakenly reads "proposed . . . use" out of the statute.[4]

In seeking to reconcile its holding with the second sentence of § 506(a), the majority below advanced two principal arguments, both of which are seriously flawed. First, the majority asserted that it was not *required* by the language of § 506(a) to consider the "proposed disposition or use" of the property in valuing the collateral:

> The phrase "in light of," however, suggests that the court need only consider the proposed disposition or use . . .; it does not necessarily dictate that such disposition or use will necessarily affect the result. We would expect Congress to use more forceful language if the proposed disposition or use of the collateral were to have a positive or negative effect on value in every case.

Pet. App. 24a-25a (citation and footnote omitted).

The argument simply ignores the relevant language of the provision. Congress *did* use forceful language. Section 506(a) contains the mandatory verb "shall," not a permissive phrase such as "may consider." It states: "Such value *shall* be determined in light of . . . the proposed disposition or use"—language that cannot be squared with the conclusion below that the actual disposition or use is of no moment in applying § 506(a). (Emphasis added). This phrase cannot fairly be read as giving courts the discretion, at a hearing on a specific "proposed disposition or use," to value the property based on an *entirely different* disposition or use, or to allow debtors to "use" encumbered property while paying only the value of the

[4] The Fifth Circuit's standard also ignores the statutory command that the valuation would vary with "the purpose of the valuation." If a foreclosure standard must be applied at the *plan confirmation stage* of a bankruptcy case, when there is no longer any uncertainty as to the proposed disposition or use, then it is hard to imagine any other stage of the case or any other purpose for which a different measure of value would prevail.

property as if it had been disposed of. As the Fourth Circuit colloquially explained: "If the 'proposed use or disposition' provision is to have any meaning, the debtor should not be permitted to 'eat with the hounds and run with the hares.'" *Coker* v. *Sovran Equity Mortgage Co.* (*In re Coker*), 973 F.2d 258, 260 (4th Cir. 1992) (quoting *In re Crockett*, 3 B.R. 365, 367 (Bankr. N.D. Ill. (1980)).

The majority's second argument seeks to give the second sentence of § 506(a) an extraordinarily crabbed meaning by positing that in a rare case, bankruptcy judges applying this language would have the *discretion* to consider the actual disposition or use of the collateral if "the manner of that retention is so unusual or extreme as to constitute a use that is destructive of the collateral." Pet. App. 26a. "For example, the collateral may consist of equipment which is being used by the debtor twenty-four hours per day, so that its use is causing rapid deterioration." *Id.* at 25a.

This example demonstrates the extent to which the Fifth Circuit misunderstood the statute. Section 506(a) deals with the value of the collateral *at the time of its valuation*. Under any standard of valuation, an asset is not worth any less *at the time it is valued* because the debtor later will use it 24 hours a day. The intensity of the anticipated future usage may be important in deciding whether the creditor is adequately protected under § 361 or is receiving a distribution that preserves its secured position under § 1325(a)(5)(B)—but it has no bearing whatsoever on the determination of the amount of the secured claim under § 506(a). For example, if collateral is anticipated to depreciate rapidly after confirmation, the secured claim might have to be paid out over a shorter time period or with a higher interest rate —but the allowed amount of the claim itself would not change.[5] Thus, the majority's reliance on rapid deprecia-

[5] Indeed, in this very case, the bankruptcy court rejected the idea "that the value of collateral should be adjusted upward if its

tion of collateral as the sole purpose of the second sentence of § 506(a) fails to withstand analysis.

Nor is there any merit in the majority's more amorphous suggestion that there may be some unspecified "equitable consideration" which would permit wholesale value to serve as a "*starting point* for the valuation," leaving a bankruptcy court free to "make additions to or deductions from this amount depending upon 'equitable considerations arising from the facts of the case.'" Pet. App. 48a (Court's emphasis). It is clear that under the opinion below, foreclosure value is not only the "starting point." It also is the ending point of the analysis. Under the majority's approach, there are no identified circumstances in which a secured claim would be valued at more than foreclosure value.[6]

In sum, there is simply no ambiguity in the phrase "proposed disposition or use." It focuses on a central decision that a debtor must make in proposing a plan—whether to surrender the collateral for disposition by the creditor, or to continue to use it by invoking the cramdown power. By adopting a valuation measure based on a hypothetical foreclosure that has not been proposed, the decision below makes the decision whether to dispose of the collateral or to use it irrelevant to the valuation issue, in direct violation of the statutory text.[7]

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use in the debtor's hands is particularly detrimental to its value." Pet. App. 118a n.2. The court explained correctly that such a detrimental use might call for a higher interest rate or a shorter payment schedule, but has no effect on the § 506(a) valuation.

[6] By contrast, under the valuation approach advocated herein, the valuation would be dependent on the facts and circumstances on a case-by-case basis, as Congress intended. *See infra* p. 39.

[7] The court below also suggested that it is meaningful to discuss the value to the creditor of the use of property by the debtor. Pet. App. 22a (collateral in the hands of the debtor "is worth something to *both* the debtor and the creditor") (emphasis added). This is a tortured and unnatural reading. When a debtor is using property, that property has no value to the creditor other than the

C. Petitioner's Interpretation Is Consistent With the Structure of Section 1325(a).

The Fifth Circuit's interpretation is not only contrary to the language of § 506(a), but also is inconsistent with the structure of § 1325(a). That section sets forth the requirements for treatment of creditors in chapter 13. With respect to secured creditors, Congress set forth a lengthy description of what the secured creditor must receive if the debtor proposes to retain the collateral for use by the estate. Under § 1325(a)(5)(B)(ii), the secured creditor must receive "the value, as of the effective date of the plan, of property to be distributed under the plan on account of such claim [that] is not less than the allowed amount of such claim."

Under the Fifth Circuit's interpretation, this elaborate language means nothing more than that the secured creditor must receive the liquidation value of its collateral. If this is what Congress meant, surely "it could have expressed such an intent much more clearly and simply." *K Mart Corp.* v. *Cartier, Inc.*, 485 U.S. 176, 188 (1988). This is especially true because Congress already had in hand a well-established standard for requiring payment of liquidation value. That is the "best interests of creditors" test, which requires that creditors receive as much as they would have received if the estate's assets were liquidated in a chapter 7 proceeding. *E.g.*, 11 U.S.C. §§ 1129(a)(7)(A), 1225(a)(4), 1325(a)(4).

If Congress had meant to adopt a liquidation value standard, it would have drafted § 1325(a) in a simple and straight-forward way. It would have made the "best interests of creditors" test of § 1325(a)(4) applicable to all creditors (*i.e.*, by striking the word "unsecured" which now appears in that section), and would have

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amount which the debtor will pay on its loan. Thus, measuring the value to the creditor of the collateral's use by the debtor is either meaningless (*i.e.*, zero) or circular (the amount of the allowed secured claim).

eliminated § 1325(a)(5)(B)(ii) entirely. Instead, as the majority below would have it, Congress drafted the elaborate language of § 1325(a)(5)(B)(ii) to provide nothing more than that secured creditors would receive the liquidation value of their collateral, and then used words of limitation to make the best interests of creditors test of § 1325(a)(4) applicable only to unsecured creditors, because secured creditors' entitlement to liquidation value was already established in § 1325(a)(5)(B)(ii).[8] The Court should not lightly presume that Congress chose to express its intent in such an inelegant, if not bizarre, manner. The much more sensible construction of § 1325 (a)(5)(B)(ii) is that it was intended to require payment of more than liquidation value—if that reflected the proposed use of the collateral.

D. Petitioner's Fair Market Value Standard Is Consistent With This Court's Prior Cases.

Although this Court has never addressed the specific issue presented here, a number of its cases suggest strongly that the majority's foreclosure value standard cannot pass muster. For example, in *BFP* v. *Resolution Trust Corp.*, 511 U.S. 531 (1994), this Court was called upon to interpret the "reasonably equivalent value" standard of valuation for fraudulent conveyances under § 548(a)(2). In *BFP*, this Court held that the price received at a regularly-conducted foreclosure sale constituted "reasonably equivalent value" within the meaning of the statute.

A careful reading of the decision makes it clear that neither the majority nor the dissent regarded foreclosure

[8] It is further instructive that the chapter 11 best interests of creditors test applies to all creditors, secured and unsecured. 11 U.S.C. § 1129(a)(7)(A). Thus, not only did Congress know how to make such a test applicable to all creditors, but on the majority's view, the best interests of creditors test for secured creditors in chapter 11 would be redundant, because the same requirement is embodied in § 1129(b)(2)(A)(i)(II), the chapter 11 analogue to § 1325(a)(5).

value as the ordinary meaning—let alone the sole meaning—of "value." The dissent was explicit on this point, declining to equate foreclosure value with "value" under the Bankruptcy Code. "The term of choice in the bankruptcy setting seems to be 'value,' unadorned and undefined, which appears in more than 30 sections of the Bankruptcy Code, but which is, with respect to many of them, read to mean 'fair market value.'" *BFP* v. *Resolution Trust Corp.*, 511 U.S. at 550 n.1 (Souter, J., dissenting) (citing § 506(a) as an example).

The same conclusion is equally evident from the majority opinion. The majority approved a foreclosure valuation for fraudulent conveyance purposes because "Section 548 . . . seemingly goes out of its way to avoid" the standard term "fair market value," and chose to replace "standard legal terminology with a neologism." 511 U.S. at 537. There is no such neologism in § 506(a), only the conventional term "value." And in that context, the Court recognized that when property is not being sold at foreclosure, bankruptcy judges should generally "refer to the traditional common-law notion of fair market value as the benchmark," *id.* at 548; that is, the price that property would be expected to bring when sold voluntarily under normal conditions, which "is the very *antithesis* of forced-sale value." *Id.* at 537. Thus, both opinions in *BFP* confirm that there is no basis for departing from the usual understanding that "value" means fair market value and does not mean foreclosure value.

Another decision of this Court undermines the Fifth Circuit's assumption that the economic results of foreclosure are the proper measure of the collateral's value. The specific issue in *United Savings Ass'n* v. *Timbers of Inwood Forest Assocs.*, 484 U.S. 365 (1988), was whether an undersecured creditor was entitled to payment for the use of its collateral during the bankruptcy proceeding. The creditor argued that monthly payments were

necessary to protect its "interest in such property" under § 361. *Id.* at 365. "The crux of the present dispute is [whether] . . . the phrase 'interest in property' also includes the secured party's right (suspended by the stay) to take immediate possession of the defaulted security, and apply it in payment of the debt." *Id.* at 370-71.

This Court concluded that the secured creditor's "interest in property" should not be determined by reference to the results of foreclosure. "The term 'interest in property' certainly summons up such concepts as 'fee ownership,' 'life estate,' 'co-ownership,' and 'security interest' more readily than it does the notion of 'right to immediate foreclosure.' " *Id.* at 371. And this Court expressly reached the same conclusion with respect to § 506(a), the section most relevant to the instant case:

> In subsection (a) of this provision [§ 506] the creditor's "interest in property" obviously means *his security interest without taking account of his right to immediate possession of the collateral on default.* If the latter were included, the "value of such creditor's interest" would increase, and the proportions of the claim that are secured and unsecured would alter, as the stay continues. . . . .

Id. at 372 (emphasis added). In sum, this Court's rejection of foreclosure as the litmus test for valuation is contrary to the holding of the court below, which used the creditor's ability to take possession and sell at foreclosure as the only measure of its interest in the collateral.

More broadly, the notion embraced by the majority below—that a secured creditor's claim can be satisfied by payment of no more than foreclosure value—is contrary to this Court's understanding of how the Bankruptcy Code deals with a secured creditor's rights. In *Dewsnup* v. *Timm,* 502 U.S. 410 (1992), this Court interpreted the phrase "allowed secured claim" in § 506(d) as having a different meaning than the same phrase in § 506(a), to prevent a debtor's benefitting from retaining collateral

at the expense of its secured creditor by "strip[ping] down" the creditor's lien. *Id.* at 417. This Court reasoned that "[a]ny increase over the judicially determined valuation during bankruptcy rightly accrues to the benefit of the creditor," *id.*, and recognized that apart from reorganization proceedings, "no provision of the pre-Code statute permitted involuntary reduction of the amount of a creditor's lien for any reason other than payment on the debt." *Id.* at 418-19. *Dewsnup*'s approach of preserving secured creditor's traditional rights is thus diametrically opposed to the effort by the court below to narrow those rights, and to allow the debtor to retain any surplus value over what the creditor could obtain through foreclosure.

E. The Appropriate Valuation Standard Is "Fair Market Value"—the Amount the Debtor Would Pay to Purchase the Property Elsewhere.

For the reasons set forth above, the language of § 506(a), the structure of § 1325(a), and this Court's precedents undermine the conclusion of the court below that foreclosure value is the relevant measure of valuation under § 506(a) when a debtor's plan proposes to retain and use the collateral. The more natural and sensible reading of the statute is to recognize that the relevant consideration is how much the debtor would have to pay to obtain the property he or she proposes to "use."

This measure of value is consistent with the traditional notion of value as "fair market value," as determined in the "market" defined by the debtor's proposed use. This is very different from the liquidation value measure adopted by the court below, because, as this Court recognized, fair market value and foreclosure value are mutually exclusive. *BFP* v. *Resolution Trust Corp.,* 511 U.S. 531, 536-39 (1994). See discussion *supra* pp. 18-19.

However, the adoption of a fair market value standard, without more, is not sufficient to decide this case and

others like it. The relevant "market" for the fair market value determination must be defined. Otherwise, the uncertainty that has plagued the lower courts will continue—with some judges erroneously looking to a market in which secured creditors sell collateral at foreclosure, while other judges correctly look to the market in which debtors purchase such property for their use.

Stated differently, the issue of valuation cannot be determined in a vacuum, but only in the context of a relevant market. And the nature and character of that relevant market is defined by the standard set forth in the second sentence of § 506(a), based on the purposes of the valuation and the proposed use or disposition of the collateral. Thus, where a debtor proposes to use collateral, the relevant market is that of typical purchases by debtors in similar circumstances. If the goods in question, for example, are typically purchased from a retailer, then the retail price for comparable items would govern. If, on the other hand, the collateral consists of used household goods, which are typically bought and sold (to the extent they have any value at all) in flea markets, rummage sales, or through classified advertisements, both the relevant market and the resulting value will be defined by the typical way in which such goods are bought and sold.

Accordingly, under petitioner's interpretation, value will vary with the circumstances, precisely as Congress intended that it would. For example, if the debtor is a retailer who buys for resale at wholesale prices, the relevant market is the wholesale market, and wholesale value would be proper. On the other hand, if the debtor is a consumer who buys in the retail market, then retail values should be used.[9]

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[9] Tort law similarly recognizes that the value of property which has been destroyed is measured differently for different parties: "the consumer can recover the retail price; the retail dealer, the wholesale price. The manufacturer, who does not buy in a market, receives his selling price." *Restatement (Second) of Torts* § 911 cmt. d, at 473-74 (1979).

This is not to say, of course, that the value of collateral retained by a consumer is necessarily the precise amount published in a "blue book" or other guideline. To the extent that a "blue book" price reflects warranties or other elements of value which the debtor is not receiving when it retains the collateral under its plan, Pet. App. at 30a-32a, an adjustment may be necessary so that the valuation more accurately reflects the precise nature of the asset that the debtor is retaining. Similarly, there would be an adjustment to the extent that part of the fair market value of the truck is derived from items to which the secured creditor's lien does not extend.[10] But in any case, the valuation in question would reflect the nature of the debtor's rights, the scope of the creditor's interest, and the relevant market as defined by the proposed use of the collateral, all as required by § 506(a).

II. THE FIFTH CIRCUIT ERRED IN ITS INTERPRETATION AND APPLICATION OF STATE LAW, THE STATUTORY LANGUAGE, AND LEGISLATIVE HISTORY AND POLICY.

The majority below was led astray from this sensible and straightforward reading of the statute based on a number of arguments. None of these arguments has merit, and none supports the majority's conclusion.

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[10] For example, if part of the value of Rash's truck resulted from accessories that he installed as to which petitioner's lien would not extend as a matter of applicable non-bankruptcy law, an adjustment in valuation also would be required. The same principles would apply when the value of the collateral is not determined by published listings in "blue books," but requires evidence as to going concern or other values. Again, a case-by-case determination is appropriate. *See, e.g.*, S. Rep. No. 95-989, at 54 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5840 ("value" should not be construed "in every case" to mean "forced sale liquidation value or full going concern value").

A. The Fifth Circuit's Tortured Reading of Section 506(a) Is Not Required to Accommodate State Law.

The central premise of the Fifth Circuit's opinion is that allowing a secured creditor to receive more than foreclosure value would be inconsistent with state law. As a result, the court below insisted on the most explicit statutory language and the most unequivocal expression of legislative intent before it would accept any different valuation. *E.g.*, Pet. App. 10a ("the statutory language must clearly compel any departure from state law"); *id.* at 28a ("the language of that subsection does not provide the clear textual guidance necessary to command the departure from state law effected by such a valuation.") Similar expressions appear no less than three other times in the *en banc* opinion, see, *e.g.*, Pet. App. 15a, 37a, 51a, and that logic pervasively distorts virtually all of the Fifth Circuit's arguments.

The Fifth Circuit's premise is fundamentally flawed in two respects. First, the Fifth Circuit misapprehended the rights of a secured creditor under state law by assuming, incorrectly, that these rights are limited to the receipt of foreclosure value. Second, the Fifth Circuit incorrectly concluded that the Bankruptcy Code is either intended to or required to incorporate state law foreclosure remedies in determining parties' rights under a chapter 13 plan.

1. The holding below rested on the erroneous premise that a secured creditor's only right under state law is "to repossess and sell the collateral *and nothing more.*" Pet. App. 14a (emphasis added). The assumption that state law limits secured creditor rights to foreclosure value is not unique to the *en banc* majority; it forms a basis for the Seventh Circuit's "split[] the difference" rule as well. *In re Hoskins*, 102 F.3d 311, 313-14 (7th Cir. 1996) (majority opinion); *id.* at 315 (concurring opinion). But it is flatly wrong.

A secured creditor certainly has the right under state law to sell collateral at foreclosure—but that is far from its only right. Rather, the creditor's most important right under state law is to be *paid in full*—and to enforce that right, the creditor is entitled "to retain the lien until the debt [has been] paid off." *Nobelman* v. *American Sav. Bank*, 508 U.S. 324, 329 (1993). On the other side of the coin, the debtor has no right under state law to keep the collateral after a default—and certainly no right to a discharge of the lien—unless he pays the entire debt. See, *e.g.*, Uniform Commercial Code § 9-506, as adopted in Texas, Tex. Bus. & Com. Code Ann. § 9.506 (debtor in default may redeem collateral upon "tendering fulfillment of all obligations secured by the collateral" plus the secured creditor's expenses and, if so provided in the loan documents, its attorney's fees).

The majority's analysis of state law is thus flawed because it seeks to define the extent of state law property rights solely by reference to what might be recovered through the use of certain state law remedies. Its analysis of state law begins with the statement that "Texas law offers a secured party two *remedies* against a debtor in default," Pet. App. 9a (emphasis added), but it leaps to the conclusion that this reflects a limitation on the creditor's substantive state law rights. *Id.* ("ACC was secured under § 9.504(a) and § 9.505 to the extent of what it could realize by resort to these two remedies.") But the inadequacy of particular state law remedies to fully vindicate a state law right does not mean that the right itself has been curtailed. The only substantive state law limitation on a secured creditor's rights to recovery from its collateral is that it cannot recover more than the amount of its debt. The fact that upon foreclosure the asset value is not sufficient for that purpose is a matter of economic happenstance; it is not a limitation of the creditor's substantive state law property rights.

Significantly, the secured creditor's entitlement to repayment of its full debt is firmly rooted in debtor-creditor

law. During the Depression, Congress enacted a bankruptcy provision that allowed farmers to discharge mortgages without repaying the entire debt. In finding the statute to be unconstitutional, this Court pointed out how unprecedented it was: "No instance has been found, except under [this] Act, of either a statute or decision compelling the mortgagee to relinquish the property of the mortgagor free of the lien unless the debt was paid in full." *Louisville Joint Stock Land Bank* v. *Radford*, 295 U.S. 555, 579 (1935). More recently, in *Dewsnup* v. *Timm*, 502 U.S. 410, 419 (1992), this Court quoted the foregoing passage from *Radford*, and stated: "Congress must have enacted the Code with a full understanding of this practice," and declined to disturb "what was bargained for by the mortgagor and mortgagee." *Id.* at 417.

Thus, when § 506(a) was adopted, Congress knew that the value of having a lien was not limited by state law to the amount that the creditor could recover by disposing of the collateral. Congress also knew that under state law, debtors who want to keep property that they have pledged as collateral must pay the full amount of the secured debt. Congress elected to modify those rights to afford some relief to debtors. To keep collateral, they need not repay the full debt, as they would under state law, but only an amount equal to the value of the collateral. See §§ 1129(b)(2)(A), 1225(a)(5)(B) and 1325(a)(5)(B).[11] But under the Fifth Circuit's own reasoning,

[11] In addition, a chapter 13 plan must deal with the unsecured portion of the claim (*i.e.*, the amount by which the debt exceeds the value of the collateral), but unsecured claims are often discharged with the payment of a pittance (as in this case) or nothing at all. This is because a chapter 13 plan can be confirmed under the Bankruptcy Code even if unsecured creditors receive little or nothing, as long as two pertinent requirements are met. First, unsecured creditors cannot receive less under a chapter 13 plan than they would in a chapter 7 liquidation. *See* § 1325(a)(4). Second, the debtor must commit to the plan all of his projected disposable income for the next three years. § 1325(b). Thus, a chapter 13 plan does not have to pay anything to unsecured creditors if the debtor does not have sufficient non-exempt assets or disposable income.

absent the clearest indication, there is no reason to suppose that Congress went beyond this explicitly-enacted departure from state law to disturb the balance between debtors and creditors in a way that would deprive creditors of the economic benefits that flow from a debtor's desire to retain his property rather than see it sold at foreclosure.

The Bankruptcy Code should not be presumed to have overridden creditors' state law entitlements. Even in Supremacy Clause cases, where Congress has enacted an express pre-emption provision and thus has satisfied the clear statement requirement for pre-emption, this Court still insists that the express provision be construed narrowly to preserve as much of state law as possible. See, *e.g.*, *Cipollone* v. *Liggett Group, Inc.*, 505 U.S. 504, 518 (1992). By similar reasoning, § 506(a) should be construed narrowly not to unduly interfere with creditors' state law right to full payment. Thus, although the court of appeals' basic instinct to preserve substantive state law rights was sound, its application was absolutely wrong.

The same conclusion is evident when the matter is analyzed from the standpoint of the debtor's rights under state law. Under the majority's holding, not only can a debtor retain collateral by paying less than the amount of the debt, but the debtor is not even required to pay what it would cost to purchase the same property elsewhere. There is certainly nothing in state law that gives debtors a general dispensation to purchase their vehicles at wholesale when everyone else must pay retail, and nothing in state law to suggest that the rule should be different when the vehicle is pledged to a secured creditor. And "[u]nless some federal interest requires a different result, there is no reason why" a debtor should obtain an expansion of his substantive state law entitlements "simply because [he]

is involved in a bankruptcy proceeding." *Butner* v. *United States*, 440 U.S. 48, 55 (1979).

In sum, in order to interpret the Bankruptcy Code in a way that most closely mirrors the outcome under state law, the appropriate valuation standard is one which would follow the dictates of § 506(a), and base the valuation on the proposed treatment of the collateral under the debtor's plan. The creditor stands to recover less for the collateral if it is surrendered, and more if the debtor continues making payments under a plan in an attempt to keep the collateral. This is much the same as would obtain under state law, where the creditor will receive more than foreclosure value from a debtor who seeks to retain the collateral. The Fifth Circuit's approach, by contrast, adopts a uniform rule that is inconsistent with the results that would obtain under state law.[12]

2. The Fifth Circuit's analysis contains a more fundamental flaw. The court erred when it concluded that the Bankruptcy Code should be interpreted, if at all possible, to allow secured creditors the same recovery that they could expect from exercising their rights under state law. "[N]ot only must ACC's reading of § 506(a) comport with the statutory language, but the statutory language must clearly compel any departure from state law produced by that reading." Pet. App. 10a. This argument confuses (1) substantive state law property rights, which the Bankruptcy Code ordinarily does not seek to modify; and (2) state law remedies, whose modification is one of

[12] As the Seventh Circuit noted, moreover, the likely result under state law is that the parties would negotiate a value between what the creditor could receive on foreclosure, and what the debtor would have to pay to purchase a similar asset elsewhere. *In re Hoskins*, 102 F.3d 311, 315 (7th Cir. 1996). As noted below, at pp. 40-41 *infra*, there would be no such negotiations under the majority's approach, because the debtor would have no incentive to negotiate once it is assured of paying no more than liquidation value. In this additional respect, therefore, the Fifth Circuit's result departs from the outcome under state law.

the purposes of the bankruptcy laws, and the share of the bankruptcy estate that is to be recovered by the various participants in the process, which is a matter decided by federal law.

When Congress enacted the Bankruptcy Code, it intended a fundamental overhaul of the rules governing enforcement of secured creditors' remedies. The Senate Report makes this clear:

> [T]he existing chapter 13 statute is basically and seriously defective . . . . [S]ecured creditors are dealt with erratically, tediously, and uncertainly, resulting from a hodgepodge of state and federal statutory provisions, bankruptcy and local rules, many conflicting reported cases and varied local customs.

S. Rep. No. 95-989, at 13, 1978 U.S.C.C.A.N. at 5799. This Court similarly observed that "Congress intended 'significant changes from current law in . . . the treatment of secured creditors and secured claims.' " *United States* v. *Ron Pair Enters., Inc.*, 489 U.S. 235, 240 (1989) (quoting H.R. Rep. No. 95-595, at 180 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6141) (Court's ellipses).

Thus, the Bankruptcy Code was not intended to produce the same recoveries by secured creditors as the "hodgepodge" of state laws. Those laws reflect the judgment made by each state about the proper balance between creditors' rights and debtors' rights. See *BFP* v. *Resolution Trust Corp.*, 511 U.S. 531, 540 (1994). In adopting the Bankruptcy Code, Congress struck its own balance between the interests of creditors and the interests of debtors—and did not seek merely to incorporate state-law procedural rules and remedies.[13] Indeed, this Court

[13] As this Court has noted, "all bankruptcy law . . . modifies the procedural rights available to creditors to protect and satisfy their liens." *United States* v. *Whiting Pools, Inc.*, 462 U.S. 198, 206 (1983). "The Bankruptcy Code provides secured creditors various rights, including the right to adequate protection, and these rights *replace* the protection afforded by possession." *Id.* at 207 (emphasis added).

has interpreted § 506 to grant secured creditors a recovery out of the bankruptcy estate that was *more* than they could receive in a state-law foreclosure. See *Rake* v. *Wade*, 508 U.S. 464, 468 (1993) (oversecured creditor entitled to postpetition interest even if state law did not require such interest to be paid).

The court below asserted that it was relying on the canon of construction that "the statutory language must clearly compel any departure from state law." Pet. App. 10a. But there is no such canon of construction relevant to the issue in this case. The court purported to rely on "*Butner* and its progeny," *id.*, but *Butner* v. *United States*, 440 U.S. 48 (1979), does not establish a rule for interpreting provisions of the bankruptcy statute. On the contrary, the *Butner* principle comes into play only when the issue involves altering a party's state law substantive property rights and the bankruptcy law is *silent* on the particular matter at issue. Thus, the Court in *Butner* relied on the lack of any basis in the bankruptcy statute for disregarding state law:

> The minority of courts which have rejected state law have not done so because of any congressional command, or because their approach serves any identifiable federal interest. Rather, they have adopted a uniform federal approach to the question of the mortgagee's interest in rents and profits because of their perception of the demands of equity. . . . But undefined considerations of equity provide no basis for adoption of a uniform federal rule. . . .

Id. at 55-56. Here, of course, the Court *is* dealing with an explicit "congressional command"—the command of § 506(a)—and an unquestioned federal interest in determining how much secured creditors are entitled to receive when debtors invoke the Bankruptcy Code's cramdown power. Nor is there any conflict with state law, because there is no state law prohibition on creditors' receiving any particular value for their collateral. And perhaps

most important, the issue in this case is the share of a bankruptcy estate to be obtained by the secured creditor, a subject about which state law is not only silent, but also as to which state law has no legitimate interest. As the dissent below correctly observed, its interpretation of § 506(a) "would not 'displace' a well-established area of state law, for the simple reason that there is no state law regarding the rights of secured creditors in reorganizations." Pet. App. 69a (Jerry E. Smith, J., dissenting).[14]

B. The Fifth Circuit Misconstrued the First Sentence of Section 506(a).

The Fifth Circuit incorrectly assumed that the "value" referred to in the first sentence of § 506(a) is the *value to the creditor of having a lien*. But § 506(a) requires a determination of the value of *the property*, not the value of having a lien. "The phrase 'value of such creditor's interest' in § 506(a) means 'the value of the collateral.'" *United Sav. Ass'n* v. *Timbers of Inwood Forest Assocs.*, 484 U.S. 365, 372 (1988) (quoting H.R.

[14] The relationship between the Bankruptcy Code and state law here also stands in stark contrast to *BFP* v. *Resolution Trust Corp.*, 511 U.S. 531 (1994), where the Court was construing the fraudulent transfer provision of the Bankruptcy Code, § 548. The Court pointed out that fraudulent transfer statutes have been a part of Anglo-American jurisprudence for over 400 years; they exist in every state, and they have been a part of every bankruptcy statute. Indeed, the very phrase that the Court was interpreting—"reasonably equivalent value"—is found in many of the state statutes. The Court therefore concluded that, in the absence of "clearer textual guidance," the federal fraudulent transfer statute should not be given an interpretation that is a "radical departure" from the longstanding interpretation of the state law counterparts, which would subject parties to liability under the Bankruptcy Code for a transaction that was lawful under well-established state law. *Id.* at 543. Here, unlike *BFP*, there is no provision of state law comparable to either § 506(a) or § 1325(a)(5)(B), and no state law provisions for cramdowns, for the stripping down of liens, or for debtors to receive discharges from their obligations, all of which are uniquely matters of federal bankruptcy law.

Rep. No. 95-595, at 181, 356, 1978 U.S.C.C.A.N. at 6141, 6312). Other opinions of this Court demonstrate the same understanding: "Subsection (a) of § 506 provides that a claim is secured only to the extent of the *value of the property* on which the lien is fixed. . . ." *United States* v. *Ron Pair Enters., Inc.,* 489 U.S. 235, 239 (1989) (emphasis added). "Section 506(a) provides that an allowed claim secured by a lien on the debtor's property 'is a secured claim to the extent of the *value of* [*the*] *property*'; to the extent the claim exceeds the value of the property, it 'is an unsecured claim.'" *Nobelman* v. *American Sav. Bank,* 508 U.S. 324, 328 (1993) (emphasis added) (Court's brackets).[15]

Despite this authority, the Fifth Circuit concluded that § 506(a) requires a valuation from the creditor's perspective because it uses the phrase "creditor's interest." Pet. App. 14a. In fact, however, the first sentence of § 506(a) refers *both* to the "creditor's interest" and to the "estate's interest" in the property. Thus, the wording of this sentence—as opposed to the second sentence of § 506(a)—does not give any basis for choosing one perspective over the other.

The court below also argued that "[i]f Congress intended the first sentence of § 506(a) to indicate only that a claim was secured to the extent of the value of the collateral, it could have drafted it with more economy." Pet. App. 11a. But the same criticism can be leveled—

[15] The legislative history cited by the Court in *Timbers* supports this interpretation. The committee reports state very clearly that a creditor's secured claim under § 506(a) is the "value of his collateral." S. Rep. No. 95-989, at 68, 1978 U.S.C.C.A.N. at 5854; H.R. Rep. No. 95-595, at 181, 356, 1978 U.S.C.C.A.N. at 6141, 6312. The committee reports also state that "going concern value" should be used in appropriate cases for valuing collateral under § 506(a). H.R. Rep. No. 95-595, at 356, 1978 U.S.C.C.A.N. at 6312; S. Rep. No. 95-989, at 54, 1978 U.S.C.C.A.N. at 5840. By definition, "going concern value" refers to the value of the property as part of the debtor's business—not the value which the creditor could realize by foreclosing.

with even greater force—at the Fifth Circuit's interpretation. There would be no reason for Congress to have used the circumlocution "the value of such creditor's interest in the estate's interest in such property" to define the amount of a secured claim if it really meant "the value to such creditor of its interest in such property"—or, even more specifically, "the amount realizable by such creditor upon its disposition of such property." More important, the drafters were interested in precision, not economy. The first sentence refers to the "estate's interest in such property," to take into account situations in which the debtor has only a partial interest in the asset (such as a percentage interest, a life estate, or a leasehold interest). It also refers to "the creditor's interest in the estate's interest in such property," to take into account situations in which the creditor's lien is limited (such as a second mortgage, where the property interest would be limited by the first mortgage indebtedness). But there is nothing in the first sentence of § 506(a) that supports the majority's conclusion, or that requires that collateral should be valued from the creditor's perspective.

C. Section 1325(a)(5) Does Not Require a Liquidation Value Standard.

The court below argued that the language and legislative history of § 1325(a)(5) required the use of a liquidation measure of value, notwithstanding § 506(a). But there is no inconsistency between the two sections. Section 1325(a)(5) allows a debtor to decide whether to use the property or to surrender it for disposition by the creditor, and § 506(a) requires that the collateral be valued on the basis of that "proposed disposition or use."

The court below held that § 1325(a)(5) does not permit a retail valuation of collateral because such a result would allow secured creditors a greater recovery when debtors keep collateral than when they surrender it. Such a result, the court reasoned, would defeat the perceived statutory purpose of providing "two . . . equivalent meth-

ods of protecting the creditor's security interest," each of which "would yield the same result." Pet. App. 19a.

But § 1325(a)(5) does not state that the two alternative treatments of secured creditors must be "equivalent." They plainly are not. One delivers hard value immediately, while the other offers only promises. If the collateral is surrendered under subsection (C), the creditor recovers at once. By contrast, if the debtor keeps the property under subsection (B), the creditor must wait to be paid, and bears the risk that the debtor will (once again) default on his obligations. This is a serious risk. "Debtors in Chapter 13 fail at extraordinary rates, with fewer than a third still making payments an average of two years after confirmation." [16] Although the secured creditor has the protection of a lien, that hardly assures full recovery of the amounts promised in the plan. The collateral may decline in value or be damaged or lost, so that it will be inadequate to satisfy even the reduced amount that the debtor is required to pay under the plan. Moreover, the creditor is likely to incur substantial additional costs to enforce the lien.

From the debtor's standpoint, by contrast, subsection (B) is very attractive. The debtor is allowed to retain property in which he has no equity, and is also allowed to strip down the lien. Moreover, the very fact that the debtor has decided to pay for the property rather than surrender it means that it is *worth more* to him than its foreclosure value. And the fact that the debtor has

[16] Teresa A. Sullivan *et al., As We Forgive Our Debtors* 222 (1989). The same results are confirmed by other surveys. *See* William C. Whitford, *The Ideal of Individualized Justice*, 68 Am. Bankr. L.J. 397, 410-11 (1994) (only 31% of chapter 13 plans are successfully completed); *Hearing on the Bankruptcy Reform Act of 1978 Before the Subcomm. on Courts of the Senate Comm. on the Judiciary*, 97th Cong. 36, 52 (1981) (statement of Claude Rice, Attorney, McDowell, Rice & Smith) (only 30% of the cases closed that year involved debtors who paid to completion).

avoided relief from the automatic stay usually means— as the bankruptcy court expressly found in this case— that the property is "necessary to an effective reorganization." See § 362(d)(2)(B). Simply put, the property is worth more when used by the debtor than when disposed of. "Congress presumed that the assets of the debtor would be more valuable if used in a rehabilitated business than if 'sold for scrap.'" *United States* v. *Whiting Pools, Inc.*, 462 U.S. 198, 203 (1983) (quoting H.R. Rep. No. 95-595, at 220, 1978 U.S.C.C.A.N. at 6179).

In short, the cramdown option under subsection (B) not only forces the creditor to bear greater risks, it offers the debtor greater benefits. Thus, there is no basis for assuming, as the court below did, "that these alternatives would yield the same result" for the secured creditor. Pet. App. 19a. Indeed, the express language of § 506(a) makes it clear that the amount of the secured claim depends on the "proposed disposition or use." This provision textually refutes any notion that § 1325(a)(5) contains some sort of implicit requirement of "equivalence." The substance of a cramdown is that the debtor is allowed to purchase collateral in which he has no equity by paying what it is worth to him—namely, the amount he would have to pay for it elsewhere.

D. The Fifth Circuit Was Wrongly Concerned About Giving Secured Creditors a "Windfall."

The court below next argued that a fair market value standard should not be adopted lest creditors reap "'a windfall merely by reason of the happenstance of bankruptcy.'" Pet. App. 37a (quoting *Butner*, 440 U.S. at 55). At most, however, this "windfall" argument is a two-edged sword. A creditor who receives retail value is receiving more than it could obtain by foreclosure (albeit subject to the risks of delayed collection). But by the

same token, it is the debtor who obtains a windfall when he retains a truck without paying its full retail value. Any attempt to determine which party is more "worthy" of economic benefit is utterly beside the point. The issue is one of statutory interpretation based on language and this Court's prior holdings, and these factors clearly weigh against the conclusion reached by the Fifth Circuit.

In any event, it is meaningless to suggest that creditors receive a *windfall* in bankruptcy. The most that a creditor can hope to recover is the amount lawfully owing—and undersecured creditors cannot recover even that much. As Chief Judge Wallace pointed out for the Ninth Circuit, "there is no reason to reduce the amount of an already undersecured claim to the forced sale value of the property at the time of the plan's approval, when no forced sale is contemplated." *Taffi* v. *United States (In re Taffi)*, 68 F.3d 306, 308 (9th Cir. 1995), *aff'd on reh'g en banc*, 96 F.3d 1190 (9th Cir. 1996), *petition for cert. filed* (U.S. Oct. 31, 1996) (No. 96-881). The Bankruptcy Code establishes a system for allocating losses; it *never* creates creditor windfalls. "Reorganization, in its fundamental aspects, involves the thankless task of determining who should share the losses incurred by an unsuccessful business." S. Rep. No. 95-989, at 10, 1978 U.S.C.C.A.N. at 5796. Thus, a creditor does not receive a windfall when it is able to reduce the loss which it otherwise might incur.

On the other hand, debtors *can* and *will* receive windfalls under the Fifth Circuit's interpretation. In every case, the debtor gets to keep collateral at a bargain price that is less than the amount of the undersecured debt, thereby giving him an economic advantage over others, including potential competitors, who did not avail themselves of bankruptcy. In addition, the Fifth Circuit's reading of the statute "would allow a reorganizing debtor to reap a windfall by stripping down the lien to liquidation value and quickly selling the collateral at fair market

value, thus pocketing equity that would have been completely beyond reach save for the filing of the bankruptcy petition." *Winthrop Old Farm Nurseries, Inc.* v. *New Bedford Inst. for Sav. (In re Winthrop Old Farm Nurseries, Inc.)*, 50 F.3d 72, 76 (1st Cir. 1995).[17] Similarly, if a vehicle were stolen or destroyed in an accident, the debtor may be able to recover the replacement cost (*i.e.*, fair market value) under his insurance policy. Once again, he would only have to pay foreclosure value to the secured creditor, and could keep the difference.

Nor is there any bankruptcy principle which denies secured creditors the prospect of some relative economic advantage in minimizing their losses. In fact, creditors are *supposed* to receive a "surplus" compared to what they would recover in a liquidation of the debtor's assets under chapter 7. This surplus is an essential feature that distinguishes chapter 13 from chapter 7. If a debtor files under chapter 7, he loses most or all of his non-exempt assets, which are liquidated to pay creditors, but he obtains a discharge that allows him to keep all future earnings. By contrast, a debtor who files under chapter 13 is generally allowed to retain his assets, but must dedicate a portion of his future earnings to meet his obligations under the plan. The debtor is allowed to choose this alternative only if it will generate a surplus for creditors compared to the liquidation alternative. Specifically, a chapter 13 plan cannot be confirmed unless secured

[17] The court below thought it unlikely that Rash could sell his truck for more than the wholesale price that a dealer would pay. This speculation was unfounded. The newspapers are filled with ads placed by individuals selling cars and trucks, most of whom presumably believe they can get a price higher than the trade-in or other value that a dealer would pay. And, plainly, other types of collateral, such as homes and farms, are routinely sold at prices that approximate their fair market value, rather than foreclosure value—which provides even more opportunity for a windfall to debtors who retain such collateral in their plans and then resell it later.

claims are paid in full and the court finds that unsecured creditors receive "not less than the amount that would be paid . . . if the estate of the debtor were liquidated under chapter 7." § 1325(a)(4).

What often makes this surplus possible is the debtor's ability to retain assets subject to liens. In this case, for example, Rash uses the truck (on which Associates holds a lien) to operate his freight-hauling business. The bankruptcy court found that "[t]he majority of Debtor's income stems directly from his ability to operate this truck." Pet. App. 110a. Congress plainly intended that secured creditors would share in the surplus created by a successful plan, and that they would do so by recovering the "going concern value" of their collateral, rather than its liquidation value.[18] See *Dewsnup* v. *Timm*, 502 U.S. 410, 417 (1992) ("Any increase over the judicially determined valuation during bankruptcy rightly accrues to the benefit of the [secured] creditor, not to the benefit of the debtor and not to the benefit of other unsecured creditors.")

E. The Fifth Circuit's Interpretation Is Not Supported by, and Cannot Be Reconciled With, the Legislative History.

Although the legislative history does not specifically address the issue presented in this case, it does make three points clear. First, resolution of the valuation question is to be done through case-by-case determination, and not by a single rule; second, the valuation issue ordinarily should be resolved through creditor negotiations; and third, with respect to used household goods, the secured creditor would be entitled to receive the "true value" of the goods rather than their unique value to the debtor. The Fifth Circuit's approach is not consistent with this legislative history.

[18] *See* H.R. Rep. No. 95-595, at 356, 1978 U.S.C.C.A.N. at 6312; S. Rep. No. 95-989, at 54, 1978 U.S.C.C.A.N. at 5840.

1. The Fifth Circuit interpreted § 506(a) to require the use of forced sale or liquidation value in every case. Yet the Report of the House Judiciary Committee demonstrates that this was not the drafters' intent. In discussing this provision, the Report states:

> "Value" *does not necessarily contemplate forced sale or liquidation value of the collateral*; nor does it always imply a full going concern value. Courts will have to determine value on a case-by-case basis, taking into account the facts of each case and the competing interests in the case.

H.R. Rep. No. 95-595, at 356, 1978 U.S.C.C.A.N. at 6312 (emphasis added). The Report of the Senate Judiciary Committee makes this point even more clearly:

> Neither is it expected that the courts will construe the term value to mean, *in every case*, forced sale liquidation value or full going concern value.

S. Rep. No. 95-989, at 54, 1978 U.S.C.C.A.N. at 5840 (emphasis added).[19] Thus, both the House and Senate Committee Reports rejected the Fifth Circuit's interpretation that courts should always use forced sale or liquidation value.

2. The legislative history is also clear that the difference between going concern and liquidation values was expected to be the subject of negotiations between the parties. As noted in the House Report:

> In any particular case, especially a reorganization case, the determination of which entity should be

[19] The Senate's recognition that valuation will vary with the circumstances is particularly significant, because it was the Senate bill that added the language that now comprises the second sentence of § 506(c). S. Rep. No. 95-989, at 68, 1978 U.S.C.C.A.N. at 5854. *Cf.* H.R. 6, 95th Cong. (1977) (original House bill); 124 Cong. Rec. H11089, H11095 (daily ed. Sept. 28, 1978) (statement of Chairman Edwards), *reprinted in* 1978 U.S.C.C.A.N. 6436, 6451 (House adoption of Senate bill).

> entitled to the difference between the going concern value and the liquidation value must be based on equitable considerations based on the facts of the case. *It will frequently be based on negotiations between the parties. Only if they cannot agree will the court become involved.*

H.R. Rep. No. 95-595, at 339, 1978 U.S.C.C.A.N. at 6295-96 (emphasis added); see also *id.* at 224, 1978 U.S.C.C.A.N. at 6183 ("The parties are left to their own to negotiate a fair settlement.").

Under the Fifth Circuit's rule, there would be no incentive for the debtor to negotiate. Debtors would simply pay foreclosure value, and nothing more. By contrast, under the retail or fair market value standard, negotiations are likely because each party is at risk for a less favorable outcome. The debtor would negotiate to retain the collateral for less than the retail value it would have to pay to replace it. The secured creditor, on the other hand, would be amenable to such negotiations, because it faces the threat that the debtor would surrender the collateral—leaving the creditor to recover as little as foreclosure value—as well as the uncertainties and litigation burden associated with the determination of the precise valuation amount and the terms of its plan treatment. This process of negotiation, which likely would yield an agreed compromise valuation, was a feature of pre-Code practice which Congress intended would continue under the Code.[20] But such negotiations will not occur under the

[20] Under Chapter XI of the Bankruptcy Act, negotiations between the debtor and its secured creditors became the norm, with secured creditors willing to concede part of the going concern surplus to avoid liquidation. *See* Richard F. Broude, *Cramdown and Chapter 11 of the Bankruptcy Code: The Settlement Imperative,"* 39 Bus. Law. 441, 442-43 (1984). It was contemplated that the uncertainties as to valuations, interest rate, and other issues would lead to similar negotiations under the Bankruptcy Code as well. *Id.* at 454 (statutory structure "is thus designed to bring the parties to the bargaining table in an attempt to avoid the various risks described throughout this article"); *see also Report of the Commission on the Bankruptcy Laws of the United States,* H.R. Doc. No. 93-137, pt. 1, at 259 (1973) ("creditors . . . should be permitted to bargain out this issue of allocation of the going concern bonus with the debtor").

majority's approach, because the debtor can never negotiate a more favorable valuation than the one the Fifth Circuit adopted. This is not what Congress intended.

3. In reviewing the legislative history, the Fifth Circuit purported to derive support from a portion of the legislative history that deals with household goods and other personal effects pledged as collateral. Pet. App. 40a-43a. Examined in their entirety, however, these passages are entirely consistent with, and indeed support, the valuation approach proposed by petitioner.

The passage from the House Report on chapter 13 cited by the Fifth Circuit, Pet. App. 40a-41a, dealt with creditors holding "a security interest in property that is virtually worthless to anyone but the debtor," having "little or no resale value," such as "all of the debtor's furniture, clothes, cooking utensils, and other personal effects." H.R. Rep. No. 95-595, at 124, 1978 U.S.C.C.A.N. at 6085. The House Report noted that the idiosyncratic value that the debtor would place on his own possessions enabled creditors to pressure the debtor, to the extent that "a few misguided decisions under current law" held that "a secured creditor with a $2000 [claim] secured by household goods worth only $200 is entitled in some cases to his full $2000." *Id.* That result, the House Report declared, was impermissible; rather, the creditor would be entitled only to "the true value of the goods" serving as the collateral and not "their value as leverage." *Id.*

Petitioner's valuation standard will achieve the objectives identified in the House Report. Items that are "virtually worthless to anyone but the debtor," and "have little or no resale value," will have a value close to zero. If the

household goods are "worth only $200," then that will be the size of the secured claim—and allowing the creditor a secured claim in this amount would not put any pressure on the debtor. All the creditor would receive in that circumstance is "the true value of the goods"—a term which plainly refers to their value if purchased elsewhere, and certainly does not equate to proceeds of foreclosure, because by definition, the strictures of foreclosure *impair* the value of property. Thus, the "leverage" that Congress wanted to eliminate does not exist when the debtor is simply being asked to pay on the basis of the fair market value of the property he chooses to keep. Petitioner's valuation does not assume Rash would be asked to pay more than a person off the street would pay for a comparable used truck.[21]

F. The Fifth Circuit's Approach Is Not Compatible With the "Policies" of Chapter 13.

The court below also tried to justify its result by citing a congressional policy "to encourage debtors to use Chapter 13 and make payments to their unsecured creditors, rather than to opt for a Chapter 7 liquidation." Pet. App. 43a. This kind of generalized "policy" argument, however, sheds no light on how to answer specific questions of statutory interpretation. In fact, it is speculative, at best, that requiring debtors to pay the replacement value of collateral will drive them into chapter 7 liquidations. Most confirmed chapter 13 plans provide for substantial

[21] The court below also stated that the House Report rejected a "replacement value" standard. Pet. App. 40a. If the term "replacement value" means the cost of buying *new* property to replace the old—as the House Report undoubtedly meant, when it referred to the cost of replacing clothes, furniture and utensils—then this statement is correct. But that is not petitioner's position. For property such as used cars and trucks, which have a recognized market value, "replacement value" and fair market or retail value are one and the same thing—namely, the price that a purchaser in respondents' position would have to pay to purchase a comparable truck. Pet. App. 8a n.3.

payments to unsecured creditors.[22] Thus, a higher payment on secured claims may affect the dividend to the unsecured creditors, but would not affect a debtor's election of chapter 13 over chapter 7. To be sure, there might be instances at the margin in which an individual might be able to afford liquidation value but not retail value. At most, Rash could not continue as a self-employed trucker, operating his own rig, if he is required to pay the retail value of his truck. Instead of renting his truck to a freight company and driving it in return for "rental" payments, Rash may have to find employment driving someone else's truck. There is no congressional "policy" that even frowns on such a result. Other independent truckers (who compete with Rash) must pay retail value for their trucks. Under the proper interpretation of § 506, Rash must do the same. The Bankruptcy Code does not require petitioner to subsidize respondents' operations following confirmation of a plan.

Finally, if this case is to be decided by policy arguments, it should be decided in favor of petitioner. The decision below runs contrary to the congressional policy of protecting the position of secured creditors—a policy which this Court found paramount in *Dewsnup* v. *Timm*, 502 U.S. 410 (1992). See *supra* pp. 20-21.

III. THE SEVENTH CIRCUIT'S "SPLIT THE DIFFERENCE" RULE IS A MATTER FOR CONGRESS, NOT THE COURTS.

In a recent decision, the Seventh Circuit adopted the fixed rule for chapter 13 car and truck cases that the valuation of collateral retained by a debtor would be the

[22] *See* William C. Whitford, *The Ideal of Individualized Justice*, 68 Am. Bankr. L.J. 397, 410 (1994). This study found that 28% of the plans proposed a 100% payments to unsecured creditors. Of those that did not, the average proposed payment was 34%. *Id.* Another study similarly found that chapter 13 "debtors promised to pay only about half of their debt." Teresa A. Sullivan *et al.*, *As We Forgive Our Debtors* 217 (1989).

midpoint between retail and wholesale values. *In re Hoskins*, 102 F.3d 311, 316 (7th Cir. 1996). In reaching this result, the court expressed its view that no particular valuation standard was either "enacted or excluded by the statute," but that a fixed rule was necessary because "[t]hese are tiny cases" and "a simple rule of valuation is needed." *Id.* at 314. Accordingly, the court examined the respective bargaining positions of the parties. If the debtor surrendered the collateral, according to the Seventh Circuit, the lender would recover only liquidation value—but the debtor then would have to pay the retail price if he wanted to replace the collateral. *Id.* at 315. This, said the court, was a "bilateral monopoly," and "people who find themselves in a bilateral monopoly situation will often simply agree to split the difference." So, rather than allowing the parties to negotiate the issue between themselves, the court split the difference on its own, as a matter of law, "[s]ince it is desirable to have a rule for determining value in these low-value cases rather than a flabby standard." *Id.* at 315-16.

Although the wisdom of the Seventh Circuit's rule is arguable as a matter of policy, that is not the relevant consideration here. Rather, the question is whether the Seventh Circuit's rule can be sustained as a fixed and immutable judicial implementation of a statute that does not establish such a rule. See also S. Rep. No. 95-989, at 68, 1978 U.S.C.C.A.N. at 5854 ("courts will have to determine value on a case-by-case basis").

Only last Term, this Court addressed such judicial legislation, in the context of a judicial rule subordinating certain classes of claims under the general standards of § 510(c) of the Bankruptcy Code. The Court held that any such "categorical" judicial rule "was tantamount to a legislative act" and therefore "outside the scope . . . of judicial development" under any general Congressional standard. *United States* v. *Reorganized CF&I Fabricators, Inc.*, 116 S. Ct. 2106, 2114 (1996). Accord *United States* v. *Noland*, 116 S. Ct. 1524, 1526-28 (1996) (judicial rules may not be established at a level of generality more appropriate for Congressional enactment). See also *BFP* v. *Resolution Trust Corp.*, 511 U.S. 531, 540 (1994) ("The problem [with adoption of a 70% standard for reasonably equivalent value] is that such judgments represent policy determinations that the Bankruptcy Code gives us no apparent authority to make.")

This case is no different. The Seventh Circuit adopted a fixed, midpoint valuation rule for all chapter 13 car and truck cases, irrespective of the circumstances of the parties or the facts of the case. Although Congress could have specified such a fixed rule for chapter 13 cases, it did not; instead, it relied on the replacement standard of § 506(a). If, as the Seventh Circuit suggested, it is desirable to minimize judicial and negotiating costs in "tiny cases," that is an argument better addressed to Congress, rather than a basis for interpreting an intentionally flexible and plain statute in a decidedly inflexible and non-textual manner.[23] See *Dunn* v. *Commodity Futures Trading Comm'n*, No. 95-1181, slip op. at 15 (U.S. Feb. 25, 1997).

[23] In *General Motors Acceptance Corp.* v. *Valenti* (*In re Valenti*), 1997 WL 31577, at *1 (2d Cir. Jan. 15, 1997), the Second Circuit upheld a local court rule requiring adoption of the average of retail and wholesale values "[u]nless otherwise determined by the court." The Second Circuit's opinion provides no clear criteria for how a court would make such a determination, other than reiterating the statutory standard that a case-by-case determination was appropriate, in light of the purpose of the valuation and the proposed use or disposition of the property. Thus, as a practical matter, both the local rule and the Second Circuit's decision affirming that rule involve the same type of judicial legislation as in *Hoskins*. Thus, the Second Circuit's approach violates this Court's admonitions in *Noland*, *CF&I*, and *BFP*.

CONCLUSION

For the foregoing reasons, the judgment of the court of appeals should be reversed.

Respectfully submitted,

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February 28, 1997

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NO 96-454 (6)

IN THE

Supreme Court of the United States

OCTOBER TERM, 1996

ASSOCIATION COMMERCIAL CORPORATION,
Petitioner,

v.

ELRAY RASH AND JEAN RASH,
Respondents.

Petition for a Writ of Certiorari to the
United States Court of Appeals
for the Fifth Circuit

MOTION TO DISMISS FOR MOOTNESS

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8 pp

Question Presented

Whether the case before the Court numbered 96-454 is now moot. Specifically, whether the Court can review an order confirming a plan of reorganization when the plan of reorganization has been totally accomplished and creditors paid sums petitioner claims it should have received.

Statement of the Case Revisited

Mr. Elray Rash owns and operates out of Lufkin, Texas, a Kenworth heavy truck to support himself and his wife Jean. He borrowed from the petitioner, Associates Commercial Corporation, to purchase the truck. Subsequently he and his wife filed a chapter 13 bankruptcy petition, promptly filing a proposed plan and thereafter complying with all requirements of the Bankruptcy Code, the rules and policies of the United States Bankruptcy Court for the Eastern District of Texas, and his proposed plan while awaiting confirmation and thereafter. He has never missed a payment.

In his proposed plan chapter 13 plan, Mr. Rash proposed to pay about $28,000 to the Associates, an amount he believed to be equal to the fair market value of the truck. The Associates had filed a proof of claim claiming $42,500 owed and a security interest in the truck in an equal amount. So Mr. Rash objected to the Associates' proof of claim under 11 U.S.C. §502. The Associates used the same argument to file an objection to Mr. Rash's chapter 13 plan under 11 U.S.C. §1325 (a) (5) (B).

In due course, the bankruptcy court called the §502 hearing. The bankruptcy court, sitting as finder of fact, found the value of the truck to be $31,875.
Mr. Rash then incorporated that number in his chapter 13 plan. He has since paid that amount to the Associates and has completed his plan. The Associates appealed both the §502 judgment and the court's subsequent confirmation of Mr. Rash's chapter 13 plan based on the truck value determined in the §502 proceeding. Because Mr. Rash was not required to devote a full $42,500 to his truck payments, he was able to commit to and accomplish a distribution to other unsecured creditors. He personally did not profit from the reduction in secured payments to the Associates.

Since the confirmation of the plan of reorganization the Associates has not stayed any of the orders of the bankruptcy court as they appealed those orders, first to the United States District Court for the Eastern District of Texas and then to the Fifth Circuit Court of Appeals. The Rashes continued to comply with the terms of their plan of reorganization. The plan was a five year plan. As is traditionally the case with chapter 13 plans of reorganization, priority debts were paid first out of funds available above and beyond those needed to pay the Associates and those needed to pay other secured creditors. Those priority debts were paid in full. But additional unsecured creditors were scheduled to be paid, and have been paid in the ordinary course of plan compliance until late November. At that point in time, although the Rash plan was scheduled to run until March, 1997, Mr. Rash was able to accumulate the funds to complete all sixty payments. This Court should note that Mr. Rash did not do so to raise the issue of mootness, since the plan would have been completed about the time of the due date for his reply brief on the merits anyway.

It is custom and procedure in the Eastern District of Texas, and common throughout the country with some variations, that on the receipt of all plan payments, the chapter 13 trustee delivers an accounting to the Bankruptcy Court with copies to all creditors showing that the debtors have made all plan payments and the eventual application of all funds received by the trustee. Mr. Michael Gross, the chapter 13 trustee, filed that accounting in late November of 1996. Again consistent with custom, on receipt of the final accounting, the clerk's office prepares and serves on all creditors a notice of receipt of the final accounting. All creditors, according to the notice, have twenty-five days to object to the details of the accounting. If no objection is received, according to the notice, the bankruptcy judge will be presented with the final order of discharge under 11 U.S.C. §1328 (a). The Eastern District of Texas clerk's

office issued its accounting notice on December 3, 1996. This Court should note that the execution by the bankruptcy judge of the final order of discharge under 11 U.S.C. §1328 (a) is mandatory, the only open fact question being whether all payments have been made, the accounting by the chapter 13 trustee being dispositive of that question absent a genuine fact issue concerning the accounting.

The Associates objected to the execution of the discharge order and the chapter 13 accounting on December 30, 1996. However, in their objection they raised no fact issue regarding the accounting and admit to this day that the Rashes have made all sixty payments called for in the plan of reorganization in the exact amounts called for in the plan. The procedure for objecting to a trustee's accounting is not inherently a matter requiring "notice and a hearing" under the Federal Rules of Bankruptcy Procedure, and their objection to the execution of the discharge order likewise does not require "notice and a hearing". The failure by the bankruptcy judge to execute the discharge order "as soon as practicable" would violate 11 U.S.C. §1328 (a) and further more the judge is under mandate from the Fifth Circuit, never stayed to enforce his final order confirming the Rash's plan of reorganization. On January 7, 1997, the bankruptcy judge executed the final order of discharge. The Associates has filed timely motions for rehearing.

If the Associates obtains the relief it seeks in its petition for writ of certiorari, then the Rashes will be required to pay out of pocket with no particular time deadline set, sums of money which they would not have had to pay to unsecured creditors since they had already committed all of their disposable income to the plan of reorganization pursuant to 11 U.S.C. §1325 (b). Including the stated rate of interest in the plan, the Associates has been paid $39,426.66 on their allowed secured claim. There is no mechanism nor any realistic prospect of a refund from those the other creditors paid pursuant to a final and binding court order never stayed.

The chapter 13 trustee final accounting shows that the Rashes have paid $8,516.49 to unsecured creditors, including the Associates for the undersecured portion of its claim.

The Rashes are raising this issue of mootness at the earliest practical moment. Motions for recall of the Fifth Circuit mandate and for stay of the final order of confirmation were pending before the Fifth Circuit and the bankruptcy court respectively as the Associates' petition for writ of certiorari was being submitted to this Court. The Rashes began to pay dividends to unsecured creditors which payments would have been made to the Associates with the higher truck value only after arguing the Fifth Circuit en banc appeal. Subsequently, after the Rashes had made their final plan payment, they needed confirmation from the chapter 13 trustee that they had actually made all required payments. That did not occur until December 30, 1996, when the Rashes then knew that only the Associates had raised an objection in reply to the bankruptcy clerk's notice and that the Associates was not raising an actual fact dispute regarding the trustee's accounting. The Rashes then decided to raise the mootness issue with this Court but before that could be accomplished they received the notice from this Court that the petition for writ of certiorari had been granted. In the telephone conference with this Court's clerk's office informing him of the granting of the petition, counsel for the Rashes informed the clerk of the mootness question and the imminent motion to dismiss.

This motion is not being filed to remove from the docket a case set for argument. The issue of mootness can be argued at the oral argument on the merits.

ARGUMENT FOR DISMISSING THE PETITION

1. THE CASE IS NOW TRULY LEGALLY MOOT.

This Court has never ruled on when an appeal of the confirmation of a bankruptcy plan of reorganization becomes moot. The Circuits have however developed an extensive and relatively consistent jurisprudence on the question. There is reasonable uniformity that an appeal of the confirmation of a bankruptcy plan of reorganization and any other related matters dealt with by the plan is moot when the plan has been substantially consummated. *In re Continental Airlines*, 75 F.3rd 868 (3rd Cir. 1996); *Bennet v. Veale*, 60 F.3rd 828 (6th Cir. 1995); *Matter of Manges*, 29 F.3rd 1034 (5th Cir. 1994); *Matter of Specialty Equipment Corp.*, 3 F.3rd 1043 (7th Cir. 1993); *In re Public Service Corp. of New Hampshire*, 963 F.2d 469 (1st Cir. 1992); *In re Club Associates*, 956 F.2d 1065 (11th Cir. 1992). Cases holding that the dispute before the Court has not been mooted also adopt these same principles, *In re Flagstaff Realty Assoc.*, 60 F.3rd 1031 (3rd Cir. 1995); *In re Seidler*, 44 F.3d 945 (11th Cir. 1995); *In re Public Service Co. of New Hampshire*, 43 F.3rd 763 (1st Cir. 1995); *In re CGI Industries*, 27 F.3rd 296 (7th Cir. 1994); *National Tax Credit Partners, L.P. v. Havlik*, 20 F.3rd 705 (7th Cir. 1994). Only one case with extenuating circumstances departs from these principles, *In re Chateaugay Corp.*, 10 F.3rd 944 (2nd Cir. 1993).

The principle, equitable mootness, can be simply stated. Reorganizations, all of which involve substantial impairment of the rights of many parties, need to reach completion and finality.

In the case at bar, the Associates would throw out five years of efforts by the Rashes, have the Rashes start all over again making extra payments to the Associates, jeopardize the finality of distributions to unsecured creditors or alternatively force the Rashes into either a plan which

exceeds the maximum five year chapter 13 plan payment period or forces them to pay funds in excess of their net distributable income, all without a stay, all without a bond, all without any fair arrangement to accommodate the legitimate interests of the Rashes in their own reorganization and the other creditors in that reorganization.

CONCLUSION

For these reasons, the Court should dismiss the Associates' petition for a writ of certiorari as moot.

Dated January, 1997

Respectfully submitted,

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PETITIONER'S OPPOSITION TO RESPONDENTS' MOTION TO DISMISS FOR MOOTNESS

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PETITIONER'S OPPOSITION TO RESPONDENTS' MOTION TO DISMISS FOR MOOTNESS

The Court granted the petition in this case on January 17, 1997. Upon learning of the Court's decision, respondents filed a motion to dismiss for "mootness." Their "equitable mootness" argument did not, however, arise after certiorari was granted and it does not involve the Court's Article III power to decide this case. Instead, respondents rely upon a prudential doctrine unique to certain kinds of bankruptcies that has no applicability to this case. Accordingly, for the reasons that follow, respondents' attempt to abuse the Court's certiorari process should be rejected and the motion to dismiss should be denied.

1. The facts giving rise to respondents' motion reveal clearly both that respondents could have and should have disclosed their "equitable mootness" argument sooner and that they should now be estopped to make this argument.

Moreover, even if properly preserved, the argument does not support dismissal of this case.

Petitioner filed its petition for certiorari on September 20, 1996. Because this case seemed very likely to be heard by this Court, petitioner sought a stay in the bankruptcy court on October 1, 1996. The purpose of the request for a stay was to stop payments by respondents to unsecured creditors, thereby preserving all parties' interests and rights. As of that date, no unsecured creditors had received any money, except for petitioner.

On October 7, 1996, respondents filed an opposition to the stay and urged the court to permit them to make further payments. In respondent's response filed on October 15, 1996 to petitioner's motion for hearing, respondents urged the bankruptcy court not to stay the order requiring payments because "[a]ssuming that (1) the stay is not granted, (2) unsecured creditors are paid, and (3) the Supreme Court orders that the Rashes pay additional sums under their Chapter 13 plan, only the Rashes are adversely affected by that scenario." App., *infra,* 2a. Indeed, respondents went further and argued that "the failure to grant a stay does not dispossess movant or the other plan participants of any rights, only the debtors. *And the debtors are willing to accept that risk.*" *Id.* at 3a (emphasis added). Thus, prior to their motion in this Court, respondents had unequivocally (and correctly) argued that plan consummation would not moot this case.

On October 14, 1996, respondents voluntarily accelerated payment of the remaining six installments outstanding and the balance owed to unsecured creditors—$6,915.85—to the Trustee to be distributed to unsecured creditors. Thus, instead of protecting themselves from the risk that they would pay too much if this Court ultimately decided this case in petitioner's favor, respondents voluntarily exposed themselves precisely to that risk. The bankruptcy court's order was entered denying a stay on October 16.

Respondents did not file their opposition to certiorari in this Court until December 19, 1996. The opposition made no mention of the expedited payments and no mention of the doctrine of equitable mootness as a basis for denying the petition. Instead, respondents waited for ten days *after* the Court granted the petition on January 17, and while petitioner has been busy preparing its brief on the merits, before seeking dismissal of the writ. As we demonstrate below, under these circumstances, it is clear that respondents' motion should be denied.

2. Without prior notice to this Court, respondents obtained a final order of discharge pursuant to 11 U.S.C. § 1328(a).[1] For reasons known only to themselves, respondents declined either to mention their prepayments in their opposition to Associates' petition for certiorari as a reason for denying the petition or to file a supplemental brief alerting the Court to any "new development." See Rule 15.8 of the Rules of this Court.

Instead, respondents kept their actions a secret, apparently assuming the Court would deny the petition,[2] and hoping to retain the option to argue for dismissal based on "equitable mootness."[3] Under these circumstances,

[1] Respondents correctly note (Motion 3) that Associates has filed a timely motion for rehearing in response to the bankruptcy court's order of discharge. Thus, even if a truly final discharge order properly could moot a proceeding such as the one here, which for reasons set out *infra* it does not, there is no final non-appealable discharge order in this case. Thus, the motion is manifestly premature.

[2] In opposing Associates' request for a stay from the Bankruptcy Court, respondents asserted that "[t]here is virtually no likelihood, based on historical grant [sic] of writs of certiorari, that certiorari will even be granted." *See* App., *infra,* 2a.

[3] Respondents' suggestion that this is the first available opportunity to bring the matter to this Court's attention is disingenuous. Respondents knew prior to filing their opposition to certiorari that they had accelerated their payments, but never informed the Court of their actions or that they believed the effect of their actions

the Court should invoke Rule 15.2 of the Rules of this Court, which deems waived "[a]ny objection to consideration of a question presented based on what occurred in the proceedings below, if the objection does not go to jurisdiction, . . . unless called to the Court's attention in the brief in opposition." [4] The spirit of this Rule is aimed directly at the tactics of respondents, and the policy of protecting the Court's scarce resources reflected in a grant of certiorari strongly supports denying respondents' motion. See *City of Oklahoma City* v. *Tuttle*, 471 U.S. 808, 815-816 (1985).

What makes respondents' new-found mootness suggestion completely untenable is that in their opposition to a stay in the bankruptcy court filed in October 1996, respondents correctly argued that completion of the plan would *not* moot this case and that they were willing to assume the risk that they would have to pay additional sums in the event this Court were to grant the petition and reverse the Fifth Circuit's decision. Apparently, now respondents are no longer willing to accept that risk. Nevertheless, their suggestion (Motion 5-6) that it would now be unfair to them to have the case decided adversely because no stay was ordered is nothing short of astonishing.

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would be to "moot" this case. Thus, respondents violated their duty to "disclose to the Court any and all facts that may raise a question as to mootness even though counsel is of the view that the case is not thereby rendered moot . . . ." Robert L. Stern *et al.*, *Supreme Court Practice* 721 (7th ed. 1993). It was simply improper for respondents to lay in the weeds and leap out with a quasi-mootness argument after certiorari.

[4] As we explain later, the doctrine of equitable mootness, relied upon by respondents is not jurisdictional. It is simply a doctrine based on prudential concerns arising uniquely out of extremely complex Chapter 11 bankruptcy cases. *See* pages 5-6, *infra*; *In re Continental Airlines*, 91 F.3d 553 (3d Cir. 1996) (en banc), *cert. denied*, 117 S. Ct. 686 (1997); *In re UNR Indus.*, 20 F.3d 766, 769 (7th Cir.), *cert. denied*, 115 S. Ct. 509 (1994).

3. Aside from the lack of equity in respondents' motion, it is absolutely clear that this case is not "moot" within the meaning of Article III. There is a dispute between Associates and the respondents concerning precisely how much the latter owe in order adequately to pay the secured portion of the debt at issue. Under Associates' interpretation of 11 U.S.C. § 502, respondents owed $41,000 in secured claims. The principal difference between what Associates claims as its entitlement and the amount respondents paid under the decisions below is $9,125.00. For purposes of Article III mootness, this dispute is plainly adequate to satisfy the Constitution. See 13A Charles A. Wright *et al.*, *Federal Practice and Procedure* § 3533.3, at 262 (1984) ("Claims for . . . monetary relief automatically avoid mootness . . . . Damages should be denied on the merits, not on grounds of mootness"). See also *Memphis Light, Gas & Water Div.* v. *Craft*, 436 U.S. 1, 8-9 (1978) (any not "insubstantial" claim for monetary relief defeats mootness); *Abood* v. *Detroit Bd. of Educ.*, 431 U.S. 209, 216 n.9 (1977). Thus, there is no jurisdictional obstacle to deciding this case.

Indeed, respondents do not actually assert that the Court lacks Article III jurisdiction. This failure to raise a jurisdictional issue alone should be fatal to their motion. See Rule 15.2 and discussion *supra*. Instead, they rely upon lower court decisions, applying the doctrine of "equitable mootness" in complex Chapter 11 bankruptcies to refuse to review an unstayed order that has been relied upon by third parties. See, *e.g.*, *In re Continental Airlines*, 91 F.3d 553 (3d Cir. 1996) (en banc), *cert. denied*, 117 S. Ct. 686 (1997); *In re Manges*, 29 F.3d 1034 (5th Cir. 1994).[5]

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[5] Even if the requirements for "equitable mootness" were otherwise satisfied, which they are not, there is a very serious question as to whether the doctrine has any applicability outside of the Chapter 11 context. Thus, in *Russo* v. *Seidler*, 44 F.3d 945, 947

These cited cases all involve extraordinarily complicated reorganizations where assets have been transferred, financed post petition or sold, and where courts are reluctant to attempt to unscramble the egg to the detriment of third parties. These cases expressly recognize that this doctrine is not jurisdictional in nature. *In re UNR Indus.*, 20 F.3d 766, 769 (7th Cir.), *cert. denied*, 115 S. Ct. 509 (1994) ("[t]here is a big difference between *inability* to alter the outcome (real mootness) and *unwillingness* to alter the outcome (equitable mootness)." (emphasis in original)). Based on these precedents, respondents assert (Motion 5) that, because their Chapter 13 plan is "substantially consummated," the Court should now dismiss the petition in this case.

The issue is not, however, whether the plan is substantially consummated, but rather whether this Court still can "grant 'any effectual relief whatever' to a prevailing party." *Church of Scientology* v. *United States*, 506 U.S. 9, 12 (1992) (quoting *Mills* v. *Green*, 159 U.S. 651, 653 (1895)). The answer to that question is plainly yes. If the Court decides that Associates is entitled to additional payments to protect its secured interest, then respondents can be ordered to pay that amount. There simply is no basis to doubt that effective relief remains available, which means that the case is not moot in any sense of the term under this Court's decisions.[6]

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n.3 (11th Cir. 1995), the court of appeals rejected an argument that the "substantial consummation" standard, which respondents invoke here (Motion 5), applies to Chapter 13. The logic of this limitation dovetails with Associates' argument in text, which is that the remedy of requiring the debtor to pay more to the secured creditor is an available remedy in this and probably every other Chapter 13 case and therefore the equitable mootness doctrine simply is irrelevant.

[6] Although the equitable mootness doctrine has no relevance to the case as it comes to this Court at this time, it may not be irrelevant later that debtors have paid certain creditors more than

At the end of the day, respondents' thirteenth-hour effort to avoid having the valuation issue under § 506(a) of the Bankruptcy Code decided by this Court in this case is much too little and much too late. Respondents' tactics are transparent and should be rejected. The Court properly has jurisdiction over this case and should proceed to decide the question presented in the petition, which the Court already has granted for plenary review.

CONCLUSION

For the foregoing reasons, the motion to dismiss for mootness should be denied.

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February 5, 1997

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they would have if the courts below had ruled in favor of Associates. Even though respondents informed the bankruptcy court that "the debtors are willing to accept that risk," the court still may consider those payments in deciding precisely how much respondents owe to Associates in this particular case. But that in no way eliminates the need for this Court to decide the basic valuation question presented in the petition and accepted for review by this Court.

APPENDIX

APPENDIX

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF TEXAS
BEAUMONT DIVISION

Case No. 92-10305A

IN RE ELRAY and JEAN RASH

ASSOCIATES COMMERCIAL CORP.,
Movant

vs.

ELRAY and JEAN RASH,
Respondents

RESPONDENTS' REPLY TO MOVANT'S EMERGENCY MOTION FOR STAY OF ORDER PENDING APPEAL AND REQUEST FOR EXPEDITED HEARING

Notwithstanding continuing procedural difficulties in the form of its motion, and reserving the right to continue to contend that that motion is procedurally defective, come now respondents, debtors, Elray and Jean Rash, and in opposition to the Emergency Motion for Stay of Order Pending Appeal and Request for Expedited Hearing of movant, Associates Commercial Corporation, would show this Court as follows:

1. In response to paragraph 1 of that motion, paragraph 1 suffers primarily from its omissions. Movants did seek a stay of this Court's final orders pending its appeal but failed to seek a stay in the District Court when this Court refused to stay its final orders, pending its appeal to the District Court. Furthermore, movant

subsequently failed to seek a stay of the District Court's final order in this case, and did not seek a stay of the District Court's final order when it appealed that final order to the Fifth Circuit. When the Fifth Circuit ruled en banc, movant failed in a timely fashion to follow customary procedure and seek a stay of that Court's judgment or mandate and then subsequently took the extraordinary step of asking the Fifth Circuit to recall its mandate. The Fifth Circuit has since declined to recall its mandate and the mandate has issued and arrived in this Court. Respondents would further take issue with movant's statement in paragraph 1 of its motion that there is a likelihood of success on the merits in the Supreme Court. There is virtually no likelihood, based on historical grant of writs of certiorari, that certiorari will even be granted.

2. With respect to paragraph 2 of the motion, respondents agree that unsecured creditors will shortly begin to receive their distributions. Their patience is admirable. Movant goes on to state that granting a stay would not harm other parties. It is unclear from the motion whether movant includes the unsecured creditors in the category of "other parties" but it is clear that the unsecured creditors will be harmed by movant's motion. Even considering movant's suggestion of bonds, escrow and interest, the unsecured creditors are entitled to begin treatment under the plan. More importantly, movant mischaracterizes the equities in such a stay. Assuming that (1) the stay is not granted, (2) unsecured creditors are paid, and (3) the Supreme Court orders that the Rashes pay additional sums under their Chapter 13 plan, only the Rashes are adversely affected by that scenario. The unsecured creditors will receive greater distribution than they would have had the Rashes modified their plan to accommodate the greater payments to movant, and the Rashes continue to earn a living and generate income able to be paid to movant the additional awarded sums. This

is not a pie which has stopped growing and can no longer grow. So the failure to grant a stay does not dispossess movant or the other plan participants of any rights, only the debtors. And the debtors are willing to accept that risk.

3. In paragraph 3 of its motion, in its argument, movant starts out with a gross mischaracterization of the rules. Rule 8005 does grant authority to this Court to stay its final order pending appeal but the appeal is no longer pending and Rule 8005 is limited in its application to stays pending appeal. All appellate steps contemplated by Rule 8005 are now final and this Court has been mandated to enforce its final confirmation order. There is no statutory or rule basis for the relief movant requests today in its motion in all of Title II except under 11 U.S.C. § 105. The 7000 series of the Federal Rules of Bankruptcy Procedure applies in such a proceeding, such a proceeding is an adversary proceeding, and in order for movant to obtain relief under § 105, movant must comply with the procedures in adversary proceedings, including filing an adversary proceeding, paying the filing fee, serving respondent and otherwise complying with the rules of procedure for adversary proceedings found in the 7000 series of the FRBP. Because the rights of the unsecured creditors under debtors' plan of reorganization and the administration of the plan generally are adversely affected by such a proceeding, the cause would not be allowed to proceed without joinder of all necessary parties including all unsecured creditors and the Chapter 13 trustee and so, even if this Court is willing to proceed without invoking the 7000 series of rules governing adversary proceedings, this Court should, at a minimum, not grant the relief requested without an adequate demonstration that all unsecured creditors have been served with a copy of this motion and allowed time to file their oppositions.

4. In its paragraph 4, movant cites correctly the grounds for a stay pending appeal but again no appeal is

pending. A petition for a writ of certiorari is not an appeal. If this Court were to grant relief under 11 U.S.C. § 105, the grounds for granting such a relief are dramatically different. They are the general equitable grounds for granting an injunction. Respondents have already demonstrated that movant's rights to payment of any larger sums the Supreme Court may award will not be adversely affected by this Court's refusal to grant a stay. There are no equitable grounds for the granting of an 11 U.S.C. § 105 injunction and this motion should not be granted when no such injunction would be granted if properly filed.

5. In response to paragraph of the motion, respondents have already argued that movant completely mischaracterizes the law when it cites grounds for staying a final order pending an appeal. No appeal is pending. More importantly, the Fifth Circuit has mandated that this Court enforce its final judgment enforcing debtor's chapter 13 plan of reorganization, and absent extremely unusual circumstances, this Court should not feel it has the discretion to ignore that mandate.

6. Respondents would respond to paragraph 6 of the motion by stating that Rule 8005 does not authorize this Court to stay any proceedings or make any other appropriate order when an appeal is not pending.

7. With respect to paragraph 7 of the motion, respondents would note that this argument is an argument for the Supreme Court. This Court should note that no attorney can ever represent to it that the grant of a writ of certiorari by the United States Supreme Court is ever likely.

8. With respect to paragraph 8 of the motion, respondents would reply that movant fails to recall its briefs and arguments before the Fifth Circuit. Respondents argued that wholesale value was the only appropriate measure of fair market value. Movant argued that its foreclosure value (if claimed it did better than most when it repossessed vehicles) was the only appropriate measure of

value. *Associates Commercial Corporation v. Rash*, 90 F.3rd 1036 (5th Cir. 1996) (*en banc*), agreed that wholesale value did reasonably represent fair market value and in dicta observed that a debtor might make out a case that foreclosure value was the appropriate standard. The Rashes never offered testimony as to the foreclosure value of the collateral. Their appraiser testified as to its wholesale value. *Taffi v. United States*, No. 94-55011 & 94-55019, —— F.3rd ——, 1996 WL 535055 (9th Cir. Sept. 17, 1996) is not contrary to *Rash*. It holds that fair market value and not foreclosure value is the appropriate valuation standard. But *Taffi* is totally contrary to the position and arguments of movant before the *en banc* Fifth Circuit. While respondents have not decided whether to oppose movant's petition for writ of certiorari, they are reasonably certain that the Ninth and the Fifth Circuits are not split. They would further note that while other Circuit panels have reached other conclusions, no other Circuit has taken an *en banc* position.

9. In response to paragraph 9 of the motion, respondents would state that while a split among the Circuits is a grounds for the grant of a writ of certiorari, again no attorney can colorably represent to any Court that the grant of a writ of certiorari is reasonably probable. Movant offers to this Court the vote tally of the *en banc* Fifth Circuit. Interesting background for a possible motion to reconsider (which motion was never filed), but unlikely to make any difference to the Bankruptcy Courts now mandated to comply with the Circuit's decision.

11. In response to paragraph 11, respondents would note that movant, having failed at every possible procedural step to obtain appropriate FRBP Rule 8005 stays, now advances the possibility that its petition for writ of certiorari may become moot. Final judgments not stayed can have that effect. But that is irreparable harm only to the extent that all lost causes resulting in final, non-appealable judgments, constitute irreparable harm to the loser. That results from that quirk of our judicial system

which occasionally causes some parties to win and some to lose. But the harm that results from losing cannot and should not be enjoined. The citation to ***In re Westwood Plaza Apartments,*** 150 B.R. 163 (Bankr. E.D.Tex. 1993) is particularly inappropriate. That case deals with the grounds for granting a stay pending appeal. No appeal is pending.

12. In response to paragraph 12: The failure of the unsecured creditors to receive the distributions called for by the reorganization plan is substantial harm regardless of whatever bond and interest arrangements movants may make. They are not parties to this motion, have not been served a copy of this motion and have been afforded no opportunity to reply.

13. The Fifth Circuit has already responded to paragraph 13 when it adequately weighed the public interest and then declined to recall the mandate issued after its *en banc* decision. By arguing "public interest" movant is asking this Court to second guess the Fifth Circuit. Whether the Supreme Court will advance the public interest by granting the petition for writ of certiorari is an argument to be made to the Supreme Court. There is a clear, uniform rule now in effect for the Eastern District of Texas and that is all properly this Court should address.

14. In response to paragraph 14, respondents would state that movant is not entitled to a Rule 8005 stay. There is no appeal pending.

15. With respect to paragraph 15 of the motion, respondents understand that the original trial judge in this matter has been assigned to hear this motion. Respondents do not understand why a hearing needs to be scheduled at all. From the pleadings alone it is clear that movant cannot get any motion or Rule 8005 relief but must instead seek a formal injunction under 11 U.S.C. § 105 including the filing of an adversary proceeding, the payment of a filing fee and formal service on all affected

parties including the Chapter 13 trustee and the unsecured creditors and that even then the prospects for injunctive relief are less than remote. There are no facts in dispute in this motion. No Federal Rule of Bankruptcy Procedure precludes summary disposition and denial of this motion.

Wherefore respondents pray this Court deny the Emergency Motion for Stay of Order Pending Appeal and Request for Expedited Hearing.

Respectfully submitted,

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(16)

No. 96-454

IN THE
Supreme Court of the United States
OCTOBER TERM, 1996

ASSOCIATION COMMERCIAL CORPORATION,
Petitioner,

v.

ELRAY RASH AND JEAN RASH,
Respondents.

Petition for a Writ Of Certiorari to the United States Court of Appeals for the Fifth Circuit

BRIEF OF RESPONDENT

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54 pp

QUESTION PRESENTED

Did the bankruptcy court judge apply the proper standard when he found the value of a truck in a proceeding to determine a secured creditor's allowed secured claim?

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STATEMENT OF THE CASE

This case involves the chapter 13 reorganization of Mr. Elray and Mrs. Jean Rash. Under that chapter, they were required to pay all disposable income to a trustee for distribution, under specific statutory guidelines and a plan they formulated, to their creditors. 11 U.S.C. §1325.

I. The Rash Family Business

Elray Rash is a truck owner-operator. This is the single most common form of business enterprise in the heavy trucking industry. An owner-operator owns his own truck, pays the cost of purchasing and maintaining the truck, pays for the truck's fuel and lubricants, purchases casualty loss and liability insurance on the truck, sees to its proper registry and the various state haul and highway permits it may need, seeks contracts for haul and then actually drives the truck, hoping that the contracts for haul pay for all of the above and make a living above and beyond those costs. Many thousands of Americans make their living this way.

Mr. Rash procures his contracts for haul through Lane Trucking. Lane, like most modern large trucking firms, does not own it own fleet but instead accumulates freight for haul in depots and in turn contacts a fleet of owner-operators with whom it has standing business arrangements to hitch up to its trailer and haul the trailer over the highway to its destination.

Lane is paid a lump payment based on the distance the freight is to be hauled, the nature of the freight, ordinarily non-hazardous, and the negotiated price with the customer. Lane pays Mr. Rash seventy per cent of the payment it would receive to haul the freight. Payment arrangements between trucking firms and their drivers vary

considerably, but virtually always are based on units of performance. Guaranteed payments, whether in the form of wages or salaries, are virtually unheard of.

Mr. Rash heads from his house in Jasper, Texas, Monday morning to the Lane terminal in Houston, Texas. From there he hauls fifty-seven foot tandem trailers of Coca Cola products, brewery products, Clorox, and other merchandise across Texas, Mississippi, and Louisiana.

Two important economic considerations therefore shape Mr. Rash's relationship with Lane. First, he is only paid if he drives. If he drives more, he is paid more. If he can not drive because he is sick or his truck is not operating, he is not paid. Second, he is not paid to return home.

Deadheading is an important economic fact of life for truckers. Good freight companies can help to find return freight. If a trucker can find a return load, his trip stands a much better chance of being economically successful. He needs to plan his finances so he can stand an empty haul home but operating a truck twice as far for half the revenue is a tough business.

Lane is good at arranging subsequent hauls when each is completed, but almost always Mr. Rash will have to deadhead for some part of the trip. If, for example, Mr. Rash hauls Coke to Amarillo, he may then pick up a load of Clorox in Fort Worth to carry it to Midland, where he then travels to El Paso to pick up a Shreveport load. In any case, when his week ends in Houston, he has to deadhead back to Jasper to his home.

Through these hauls, knowing the revenue is set for that trip, the trucker then operates the vehicle as economically as possible in light of fuel cost, maintenance costs, and down time costs.

Mr. Rash drives a 1989 Kenworth T-600A with a 444 Cummins six cylinder as the power plant. This is the heavy weight of over-the-highway trucks. It is painted in Lane colors. His trips are lengthy and in order to save on his travel expenses while on the road, the truck is equipped with a sixty-inch "sleeper", an extension to the cab which contains twin bunks. He can pull into a rest stop and take his DOT mandatory rest periods in his truck without having to spend for a motel. Mr. Rash always stays with his truck.

His trips are regulated by Department of Transportation regulations which require that he maintain a log of times driving as opposed to times idle and distances driven each driving time. He is allowed to drive no more than 10 hours at a time between rest periods of at least 8 hours each. Truckers do not know day from night. They only know driving periods and rest periods. Mr. Rash drives generally fourteen hours per day, Monday through Friday.

Additionally, good maintenance practice for his truck required that he keep a careful maintenance log. On the date of Mr. Rash's valuation hearing his truck had logged 380,000 miles. At present the truck has on it over 929,000 miles. It is nearing the end of its useful life, but Mr. Rash has been able to make the truck last as long or longer than anyone might expect through careful, regular and expensive maintenance, including lubrication and fluid changes, air filters, full and partial overhauls, tires, brakes, suspension, constant cleaning and polishing of the body, and replacement of consumable parts such as batteries, hoses, electric cabling, fluid pumps and so forth. These items are not priced like

automobile items. A single truck tire can cost in excess of $700. All this work Mr. Rash pays for out of his pocket. A standard lubrication and oil change servicing costs $140.00. He performed a major overhaul on his engine in 1995 at a cost to him of $6,000 and a year later he did a major overhaul on the "rear-end" (universal, differential, axle, housing and bearings) at a cost of $2,000.00. All of the funds he set aside in his plan for truck maintenance and then some have been expended on the maintenance of the truck.

Mrs. Rash is employed by the Texas Criminal Justice Department. She is a dental assistant and runs the dental clinic at the Jasper Unit of the Texas Department of Corrections, a prison located in Jasper, Texas. She is paid slightly less than $10,000 per year.

II. The Associates' Collateral: The Kenworth.

This case is about the valuation of collateral in bankruptcy. The collateral in question is a 1989 T-600A Kenworth truck. It is brown. It has a tare (empty) weight of 18,800 pounds (in excess of nine tones) and a loaded gross vehicle authorized weight of 75,000 pounds (about 37 and one half tons). It has twin fuel tanks holding 120 gallons each. It has ten twenty- inch wheels. The truck has fifteen forward gears in its standard, double-clutch truck transmission.

Mr. Rash bought his truck on March 30, 1989 from Janoe Kenworth Trucks, San Antonio for $73,700. He traded in a 1986 Peterbilt truck. When he purchased the truck, Janoe arranged for the purchase to be financed by the Associates Commercial Corp., a business which does extensive financing in the commercial field, including trucks, heavy construction equipment, manufacturing equipment, and

so forth. The principal on March 30, 1989, was $68,415.62. The Court should not assume that this was the amount that the Associates drafted to Janoe; discounts in the purchase of installment paper are now common. At the time of his bankruptcy Mr. Rash had made payments totalling $57,900 and owed a principal of $41,171 on the note.

III. Mr. Rash's Bankruptcy

In 1991, Mr. Rash had a mild stroke. He was not permitted by his doctor to drive for approximately three months. He began to fall behind and exhausted savings trying to keep his truck. During this period of time he approached both the San Antonio Kenworth dealer who sold him the truck and the Associates itself and asked the Associates to refinance his truck through this period. He had too much equity in it to just give it up. The Associates was willing to make minor concessions on the payment schedule but was unwilling to forgive any principal or interest and the three month loss of income by Mr. Rash created too large a hurdle for him to make up under the best of the Associates proposals.

The Associates then threatened repossession.

Mr. Rash reluctantly sought the advice of bankruptcy counsel. Mr. Robert Barron is an experienced chapter 13 bankruptcy practitioner officed in Beaumont, Texas. He filed for Mr. and Mrs. Rash a chapter 13 bankruptcy petition on, March 18, 1992, in the Lufkin Division of the Eastern District of Texas.

The Eastern District of Texas has one chapter 13 bankruptcy trustee, Mr. Michael Gross. In connection with chapter 13 bankruptcies the Court requires the prompt filing of a chapter 13 plan of reorganization. Mr. Rash's original chapter 13 plan is dated March 17, 1992, and he actually filed his original chapter 13 plan of reorganization with his petition. That plan called for a repayment to the Associates of $28,500, the claimed value of the truck at that time, plus interest at 9%. Mr. Rash started all plan payments to Mr. Gross within thirty days of filing his bankruptcy.

Chapter 13 plans of reorganization are of no set duration. However, they may not last more than three years without court approval. Five year plans traditionally arise in the context of the requirement that all priority debt be paid in full (generally taxes) during the course of the plan. Often the full five years is needed to pay the priority debt. In Mr. Rash's case, however, his tax debt was not significant. Instead, he asked to remain in the chapter 13 reorganization for a full five years in order to ensure that his truck be repaid entirely within the plan period. This was an extraordinary commitment on his part and by no means necessary from the perspective of the plans this bankruptcy court traditionally confirms.

In Mr. Rash's chapter 13, as in all chapter 13 filings, Mr. Rash had to report to the court all earnings and all contemplated earnings, Official Schedule J, and pay to the chapter 13 trustee all of those earnings above and beyond a family budget, 11 U.S.C. 1325 (b) (2). The family budget is initially proposed by the debtor, but both the chapter 13 trustee and the office of the United States Trustee scrutinize the budget against the thousands of similar chapter 13 budgets to catch discrepancies in allowable household expenses. The creditors also have an opportunity to view the household budget and the proposed plan and copies of these

are all distributed to the creditors and placed on public view in the bankruptcy clerk's records. The budgets are minimal and do not provide for any expenses above and beyond bare family living expenses. As a part of his budget, Mr. Rash also set aside a $400 per month maintenance and repair allowance for his truck. Mr. Rash, during the course of his chapter 13, actually spent all of that money plus an additional $600 to $700 to repair and maintain his truck. The additional sums were diverted from the household budget, or Mr. Rash worked additional hours to accumulate those funds.

Both the chapter 13 trustee and the United States Trustee also review the proposed plan for compliance with Chapter 13 requirements. When an additional $135 a month was required to fund the secured debt, Mr. Rash dropped a $50 a month charitable contribution amount and a $65 per month entertainment amount among other household expense items to fund the additional sums. Throughout this process, Mr. Rash encountered no adverse criticism from either the chapter 13 trustee or the United States Trustee.

The Associates was not Mr. Rash's only secured creditor. He had also borrowed on his home and a car and pickup. Home mortgages are exempted from the chapter 13 process, and those payments are counted in the family expense budget. He owed $15,390 on his mortgage, $4,250 on a 1988 Dodge pickup and $2,750 on a 1987 Buick. Early on Mr. Rash negotiated with and reached an agreement with the Chrysler Credit Corporation on the pickup and with GMAC on the Buick. Mrs. Rash drives the Buick to the Jasper Unit to work and Mr. Rash drives the pickup when home on the weekends. Those payments were included in the plan and did not thereafter change. Mr. Rash made all those payments successfully and was delivered title to his vehicles.

A chapter 13 debtor's schedules and proposed plan of reorganization will take a position with respect to the amount of principal the debtor contends he owes on the security interest. However, that in essence is only a pleading. The secured creditor can accept the number or reject it. The method for rejecting the number is the filing of a proof of claim. A proof of claim under sec. 502 and Rule 3001 will be deemed allowed unless a party in interest objects to the claim. Debtor's counsel found the Associates claim in his examination of the file before the confirmation hearing. He then took the necessary step to destroy the presumption; he filed an objection under §502 to the proof of claim. The §502 objection is served on opposing counsel, so well prior to the commencement of the chapter 13 confirmation hearing, counsel for the Associates was apprised of the joining of the valuation issue.

No step in the standard pattern of secured creditor litigation and contest was left unturned by the Associates. It filed the traditional motion to lift automatic stay and the equally traditional motion for cash collateral order. In both cases, it contended it was undersecured, that the collateral was not needed for the reorganization, and that it was not being paid adequate protection. The Associates knew that Mr. Rash needed his truck for his reorganization and that he had some time earlier been religiously paying on the Associates account to the chapter 13 bankruptcy trustee. Mr. Rash responded to all of these motions in a timely fashion.

By now Mr. Barron understood that the Associates intended to litigate the value of its collateral. This is somewhat unusual in that Mr. Barron has worked out standard pattern settlements with virtually every secured creditor in the community where he practices. Mr. Barron knew that the matter would involve a fact trial and so he prepared his case by taking the most obvious and logical

step. He asked Mr. Rash to have his truck appraised.

IV. The Truck Appraisal

Although apparently now an intense national debate, the question of how Mr. Rash was to appraise his truck was hardly controversial at the time. Mr. Barron required that he take the truck to a qualified truck appraiser in Beaumont and ask that the appraiser appraise the truck. Mr. Rash drove the Kenworth to Beaumont to one of the larger dealers in Beaumont, Smart's Truck and Trailer. Smart dealt in Macks and Whites primarily but handled other lines.

This pattern is repeated many times daily in the city of Beaumont alone, many thousand times daily across the nation. There are numerous individuals in any community who are qualified to, hold themselves out to, and conduct the business of vehicle appraisal. Often, they are a designated individual in a new vehicle dealership; for example, the manager of the used car division. It is not likely that they will own an independent appraisal business as in the case of real estate appraisers. While appraisals are routinely conducted, no one expects to charge a major fee to do so and no one contemplates that that activity can constitute a livelihood per se. But the process is well understood and fees are charged for it. In our case, Mr. Steven Thibodeaux, the sales manager for Smart's Truck & Trailer, introduced himself to Mr. Rash and said he would appraise the truck.

The process of truck appraisal, to those familiar with real estate appraisal, is a familiar one. Nowhere in the literature on appraisal or in the Uniform Standards of Professional Appraisal Practice is there a recognized distinction between the methods of appraising real property and the methods of appraising personal property.

Mr. Thibodeaux followed that process. First, he agreed on a fee, fifty dollars, with Mr. Rash, who then paid the fee. Then he interviewed Mr. Rash to determine the purpose of the appraisal. Mr. Rash explained to Mr. Thibodeaux the chapter 13 process and how Mr. Thibodeaux's number would be used in the process. He further told Mr. Thibodeaux that he might be called upon to testify in bankruptcy court. Mr. Thibodeaux agreed to appraise the truck's fair market value. Mr. Thibodeaux then conducted a careful physical inspection of the truck. He started it and drove it. He examined its mechanical and body components. He examined the maintenance and DOT logs. Mr. Thibodeaux then interviewed Mr. Rash as to what his driving arrangements were including whom he drove for and under what terms. Mr. Thibodeaux deals in trucks daily. He knew the value of an equivalent vehicle new and the rate of depreciation. He knew the age of the truck. He knew that Mr. Rash did not have a certain income from Lane but that his haul revenues could wildly fluctuate. He therefore immediately rejected use of the replacement cost (new minus depreciation) method (the number would end up five to six thousand dollars too low) and the income method (no sum certain income stream on which to base the calculation) and therefore adopted the comparables method. Mr. Thibodeaux had a good idea from his experience alone what the truck could get in the market place. Mr. Barron had instructed Mr. Rash to ask Mr. Thibodeaux to include both a wholesale and a retail number because Mr. Barron did not know which the bankruptcy court might require or what the Associates might try to prove. But Mr. Thibodeaux explained to Mr. Rash that the retail number was suspect because accurate retail numbers were hard to come by and further inappropriate for an appraisal. But he agreed to include a retail market conclusion. He then did some research on truck values. Mr. Thibodeaux keeps on hand a number of magazines which show offerings by truck owners of trucks

to be sold or bought. From this information and his own experience Mr. Thibodeaux was able to come up with a fair market value, which he characterized as "wholesale". He arrived at the retail number by consulting the MacLean-Hunter Market Report Blue Book (not, as has been assumed by many, the N.A.D.A. Blue Book), a report which shows actual sales of similar trucks at retail truck dealers who are reporters to MacLean Hunter. He then, based on his experience, deducted twenty-five per cent from the MacLean Hunter number and compared the number to his wholesale number. They were within a few dollars and he rounded the result. Rounding is viewed by the *Uniform Standards of Professional Appraisal Practice* not as customary but as mandatory.

He then presented to Mr. Rash a written report. He subsequently was called upon to testify in the §502 hearing.

Mr. Rash did not want to reduce his proposed distribution to unsecured creditors but the Thibodeaux appraisal was some three thousand dollars higher than his initial plan amount. So Mr. Rash cut expenses from his budget, increased his plan payments to the Associates and filed his First Amended Plan. This plan also called for secured creditors to be paid 9% interest.

At the §502 hearing, the Associates called, as plaintiff, a loan officer with the company who had no experience appraising trucks and who had never seen the truck. He gave an opinion as to the "retail" value of the truck based on reading the "Blue Book". He admitted the Associates was rarely able to get retail value when they resold repossessed trucks. The Rashes then called Mr. Thibodeaux. He testified that the value of the truck was

$31,875.00. On cross-examination by the Associates, he refused to admit that retail value was the fair market value of the truck and stuck to the value he gave on direct.

The bankruptcy judge subsequently issued his finding of fact that the value of the truck was $31,875.00. In a later hearing, the judge confirmed the Rash First Amended Plan of Reorganization which had incorporated that value as the Associates allowed secured claim.

V. Mr. Rash's Performance Under the Plan

Thereafter, Mr. Rash missed no work. He actively maintained his truck. At the end of his plan, he was successful in preserving the life of his truck, now at 929,000 miles. And he was able to stay even with the plan and his family expenses and accumulate enough reserves to prepay his plan four months early. During the course of his chapter 13 plan, Mr. Rash never missed a payment. This for five long years, the maximum time a bankruptcy court may allow a chapter 13 plan.

According to the chapter 13 trustee accounting which closed out this chapter 13 reorganization, Mr. Rash was able to pay his secured debt of $51,931.22 in full. He paid the IRS in full $2,745.00.[1] He paid $5,771.49 on unsecured, non-priority debt of $22,351.39 (including the Associates' unsecured deficiency claim) for approximately a twenty-six per cent distribution to his unsecured creditors. He made all Associates secured payments, principal of $31,875.00 and

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[1] Mr. Rash burned 103,400 gallons of diesel fuel during his reorganization, paying the United States $25,00 in federal fuel taxes and $20,680 in state fuel taxes. Additionally, he paid the United States $50,827 in income taxes during the five plan years. "Fresh start" for the United States should mean restoring a citizen to taxpaying status.

interest of $7,551.66 for a total of $39,426.66 and in addition was able to pay them another $2,400.38 on the unsecured portion of their claim. He even paid the chapter 13 trustee a fee of $4,306.97. It is hard to imagine a court requiring any more of a chapter 13 debtor.

Mr. Rash's truck is now at the end of his useful life and he needs to replace it. While it has little trade-in value, it does have some and every penny was put there by Mr. Rash's maintenance efforts.

The bankruptcy court's allowance of the lower amount to the Associates enabled the Rashes to make a significant distribution to their unsecured creditors. Had the higher amount been allowed, the monthly payment would have been $885.03 or $215.26 higher per month. There simply wasn't room in the Rash budget for that increased payment. The Rashes would not have been able to formulate and complete a Chapter 13 plan.

SUMMARY OF ARGUMENT

Creditors who file claims in bankruptcy are allowed their claims as filed unless some party objects to the claim. 11 U.S.C. §502.[2] The bankruptcy court adjudicates contested claims. 11 U.S.C. §502; F.R.B.P. 3001, 3002 and 3007.

This process is also as the method also of determining the value of a creditor's security interest. §506.

In our case today, two debtors have proposed to pay to a secured creditor, pursuant to a chapter 13 plan of

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[2] Consistent with Petitioner's brief, all citations will be to 11 U.S.C. unless otherwise indicated.

reorganization, payments which they contend have, as of the date of the confirmation of the chapter 13 plan of reorganization, a present value, §1325 (a), equal to the value of the secured creditor's collateral, a heavy truck, 11 U.S.C. §506 (a). A bankruptcy court agreed, holding that the value of that truck was to be measured by the probable net proceeds to the secured creditor if the secured creditor had repossessed and sold its collateral. This is the proper standard.

The Petitioner, the secured creditor, contends that the bankruptcy court should have valued the truck based on the debtors' having hypothetically to go out into the market and purchase a replacement for the truck. The statute does not say that. The history of the statute does not support that theory. And our every day, real world experience at resolving disputes over values also does not support that theory.

To understand why the Petitioner's theory is wrong and the bankruptcy judge's standard was proper, Respondents would first thoroughly discuss the background of this case, then the wording of §506 (a), then the history of 11 U.S.C. §506 (a), and finally how property is valued day in and day out in American commerce.

ARGUMENT OF LAW - THE VALUATION ISSUE

I. The Wording of §506 (a)

§506 (a) states:

> (a) An allowed claim...is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property...Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such

> property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor's interest.

§506 (a).

The section can be applied in all five chapter proceedings under Title 11 and in many different contexts. The language Congress provides us can be a clear roadmap, some general guidance, or no help at all in a given context.

In a Subchapter of Title 11 entitled "Collection, Liquidation, and Distribution of the Estate, 11 U.S.C. §721 et seq., a chapter seven trustee is authorized to liquidate and distribute the estate to its creditors. The trustee abandons assets of the estate in which the estate has no equity, 11 U.S.C. §554, and sells assets for cash when the estate will realize some net proceeds, See F.R.B.P. 6004.

A trustee and a secured creditor can clash over whether an asset has equity. We know in such a proceeding that the proposed disposition is auction by the trustee. The valuation adjudication is an attempt to guess at the result of the auction.

A trustee or a debtor can sell an asset free and clear of liens and encumbrances, §363, with the lien attaching to the proceeds of the sale. If a trustee, for example, proposes to continue to operate the debtor's convenience store until the stock is sold, a secured creditor with a lien on that stock could insist that the stock be valued at retail, since that is how the trustee proposes to sell the collateral.

A railroad might have a great deal of value in operations, but its rolling stock and rights of way individually may have only scrap value. In a chapter 11 reorganization, its investment bankers would put a going

concern value on the railroad when the business is proposed to be sold as a going concern.

These examples presume there is a proposed disposition of the collateral.

In our case, the proposed disposition is "none". It takes quite a reading to find any specific guidance from §506 (a) as to a specific valuation standard when there is no proposed disposition. Refine the articulation of the proposed disposition or use. The truck, it was proposed, would be used to generate revenue by hauling freight. Perhaps, had Petitioner brought evidence on that proposed disposition or use, some light would have been shed on the truck's value. A truck doesn't have "going concern value" but a truck can generate revenue. Had Petitioner pursued this line, as will be developed later, the ability of the truck to generate revenue was speculative and considerably less than most would say reflected a fair value for the truck.

One more articulation of "proposed disposition or use". The debtor proposed to retain the truck as collateral to the secured creditor's claim. That is the clearest statement of the proposed use or disposition of the truck. And §506 (a) would then say that the truck should be valued as collateral, the probable net proceeds on repossession and sale of the collateral by the secured creditor.

What was the purpose behind the valuation? In the trustee's auction example, it is to guess at the outcome of a sale to determine who gets to conduct the sale, the trustee or the creditor. But our proceeding was called to determine how much money the debtor had to propose to pay to the secured creditor in the chapter 13 plan. How much money the debtor would pay to the secured creditor to equal the probable net proceeds to the secured creditor on repossession

and sale of the truck. In other words, what was the cash equivalent value of the truck, as is, where is?

§506 (a): "Such value shall be determined...in conjunction with any hearing on such disposition or use..." 11 U.S.C. §506 (a).

The secured creditor industry has managed to scare a number of courts and other parties with the unexpected windfall argument. The argument states that, on reducing a secured creditor's allowed secured claim, a debtor can then manipulate a windfall by selling the collateral, or at least experience a windfall if the vehicle is wrecked and insurance pays a larger amount. See Pet. Brief, p. 37, NationsBank Brief, footnote 13, p. 19, both citing *Winthrop Old Farms Nurseries, Inc., v. New Bedford Inst. for Sav.*, 50 F.3d 72, 76 (1st Cir. 1995).

But those urging that theory and the *Winthrop* Court overlook a simple procedural issue in §506 (a) quoted above. The §506 (a) valuation is done solely for determining the allowed secured claim's treatment in the reorganization. A sale of the vehicle requires a separate proceeding under §363 with a separate adjudication of the distribution of the proceeds of the sale. §363. The §1325 (a) value is not res judicata the §363 value. Similarly, when a car is wrecked, the casualty loss is a §363 sale and the distribution of insurance proceeds requires the permission of the bankruptcy court in a §363 adjudication. The bankruptcy court is not bound by the §1325 (a) value. In order for the debtor to have experienced the windfall described by NationsBank someone needed to have been asleep at the switch.

Petitioner contends that you should not hypothesize a repossession and liquidation sale when none is contemplated. But how else do you determine what a discrete piece of 5

tangible personal property is worth unless you hypothesize the sale of that property?[3] When you ask the question what is a truck worth, you are asking the question what can I get for the truck if I sell it.

That is what the secured creditor would do with the truck if the debtor opted to return the truck under 11 U.SC. §1325 (a) (5) (C). The secured creditor would not use the truck to generate revenue; this secured creditor would not put it on its retail lot to sell. It would liquidate the collateral; it would sell the truck for cash.

The United States, in its amicus brief, states:

> As the court explained in In re Taffi, 96 F.3d at 1192-1193, "[t]here is nothing inequitable" in valuing collateral retained by the debtor at its fair market price for, by "allowing the [debtors] to retain [the collateral,] the [creditor] runs a risk" that ultimate recovery will be deferred or defeated. When a creditor is permitted to sell property at foreclosure, the net proceeds are then promptly received. When by contrast, the "proposed disposition" is for the debtor to retain the property, the creditor receives payment of its secured claim only in small portions over time.

U.S. Brief, p. 15.

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[3] Respondent's counsel collaborated extensively with Professor David Carlson in the preparation of his article, "Car Wars: Valuation Standards in Chapter 13 Bankruptcy Cases," Carlson, David Gray, 13 *Bankruptcy Developments journal* 1. He agrees that all valuations involve some form of hypothesis, see Id., p. 18; Carlson, David Gray, "Secured Creditors and the Eely Character of Bankruptcy Valuations", 41 *American University Law Review* 63, 70.

What the United States forgets is the Rashes paid the Associates $7,551.66 to "run that risk".

Petitioner argues:

> "Debtors in Chapter 13 fail at extraordinary rates, with fewer than a third still making payments an average of two years after confirmation."
> quoting Teresa A. Sullivan, et al., *As We Forgive Our Debtors* 222 (1989).

Pet. Brief, p. 34.[4]

The United States says:

> Studies have shown that the majority of chapter 13 plans fail. *See In re Rash*, 90 F.3d 1036, 1064 n.6 (5th Cir. 1996).

Brief of the United States, p. 26.

The Rashes' plan didn't fail. With the standard proposed by the Petitioner, it never would have gotten off the ground. Chapter 13's viability is clearly on the line in this case.

In its amicus brief, the Washington Legal Foundation argues that creditors' rights "should be impaired in bankruptcy only when necessary to maximize net asset distributions to the creditors as a group", quoting Thomas H. Jackson and Robert E. Scott, Symposium on the Law and Economics of Bargaining: On the Nature of Bankruptcy: An Essay on Bankruptcy Sharing and the Creditors' Bargain, 75

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[4] Some of these failures are in jurisdictions applying the retail standard at present.

Va.L.Rev. 155, 155-156 (1989), WLF Brief, footnote 13, p. 19. Is there any doubt that this is exactly what happened in this bankruptcy?

The United States has intervened as amicus in this case because of its involvement in the Taffi case, *In re Taffi*, 96F.3d 1190 (9th Cir. 1996). This case however is far more typical of the Internal Revenue Service's traditional role in bankruptcy. In most chapter 13 reorganizations, the Internal Revenue Service will be an unsecured creditor, competing with the secured creditor for the disposable income of the debtor.

This simple valuation standard is well supported in the case law over the years, the traditional history of bankruptcy, and the statutory history of the Bankruptcy Code. Amicus, National Association of Consumer Bankruptcy Attorneys, has done an excellent job of relating that history in her brief, and the Rashes commend the Court's attention to her brief.

The Rashes would direct the Court's attention to two specific areas. First, a view of the transition from Chapter XIII of the Bankruptcy Act to Chapter 13 of the Bankruptcy Code is especially useful to understanding §506 (a).

Second the Rashes' theory is strongly consistent with and supported by modern appraisal theory. On the one hand, courts tell appraisers how to appraise and not vice versa. On the other hand, appraisers will always appraise outside the court room with an eye toward honesty, accuracy and objectivity, and this Court should mandate fundamental alterations in appraisal methodology for only the most compelling reasons or clearest directives from Congress.

II. The Law Prior to the 1978 Bankruptcy Code

In order to understand how Congress intended of secured debt be treated in the 1978 Code, one needs to understand the changes that were made from the treatment of secured creditors under the Chandler Act, P.L. 696, 52 Stat. 840-940, June 22, 1938. In order to understand how the Chandler Act treated secured debt, one needs to understand the peculiar and unfortunate timing of the *Louisville Bank* and *Wright* cases.

Some background. Chapter 13 was actually born in the 1920's in the District of Alabama bankruptcy court. See Analysis of H. R. 12889, House Judiciary Committee print, 74th Congress, 2d Sess. at iv (1936); Hearings on H. R. 8046 before the House Judiciary Committee, 75th Congress, 1st Sess. ser. 9 at 102 (1937); Hearings on H. R. 8046 before the Senate Judiciary Committee, 75th Cong. 2d Sess. at 61-62 (1937); 81 Cong. Rec. 8646-8647 (1937). A referee there, Valentine Nesbit, noticed that a number of the individuals coming before him were not totally destitute but did have some ability and desire to make some payments on their debt. Referees were far more active in the administration of their cases under the 1898 statute. This referee began to organize debtors and creditors into committees with a goal of seeing how far some of the debtors might go in repaying their debt on an ongoing basis. All of his initial efforts were done on a totally consensual basis and he had great early success. The laudatory nature of his efforts reached Congress which, had in the early 1930's began to reexamine the 1898 Act to accommodate the tragedy of the Great Depression. 81 Cong. Rec. 8646-8647 (1937).

At this point in time an unfortunate timing in Supreme Court decisions then intervened. Congress had in its first attempts at bankruptcy reform directly addressed the question

of farm mortgages by the passage in 1934 of the Frazier-Lemke Act, June 18, 1934, c. 869, 48 Stat. 1289, 11 USCA §203 (s). The Frazier-Lemke Act added a subsection "s" to §75 of the 1898 Bankruptcy Act, March 3, 1933, c. 204, 47 Stat. 1470. That section created a system of agricultural compositions, a forerunner of our present Chapter 12, 11 U.S.C. §1201 et. seq. The subsection allowed a "bankrupt" who failed to obtain consents to a §75 composition to take one of two options.

1) The bankrupt could purchase the property at its appraised value, acquiring title and immediate possession, by agreeing to make deferred payments of 2½% within two years; another 2½% within three years; 5% within four years; another 5% within five years and the balance within six years. All deferred payments bore interest at 1%. 48 Stat. 1289, See *Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555 (1935).

2) Or the bankrupt could stay the foreclosure on or repossession of the farm for a period of five years by paying into the bankruptcy court a reasonable rental annually. 48 Stat. 1289, *See Louisville Joint Stock Land Bank v. Radford, Ibid.*, at 857.

The subsection contained a key proviso: "...Provided, however, That the provisions of this Act [subsection] shall apply only to debts existing at the time this Act becomes effective [on June 28, 1934]. 48 Stat. 1289, *See Louisville Joint Stock Land Bank v. Radford, Ibid.*, at 857.

The Radfords mortgaged their Kentucky farm to the Louisville Joint Stock Land Bank, which subsequently attempted to foreclose on the farm. The Radfords filed a bankruptcy and arranged for the referee to sell them the farm at fair market value, all pursuant to the terms of the Frazier-

Lemke Act. The Bank appealed. In *Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555 (1935), this Court held that the Frazier-Lemke Act was unconstitutional, Id. at 869. Justice Brandeis, in his opinion, emphasized that Congress' Article I authority to legislate regarding bankruptcies was virtually limitless, the sole condemning aspect of the Frazier-Lemke Act being its specific targeting of pre-existing mortgages. Id., at 581-583.

The impact of *Radford* was instantaneous and oversimplified. Congress immediately took Radford to stand for the proposition that it was not to meddle with secured debt in bankruptcy at all. *See for example* Hearings on H. R. 8046 before the Senate Judiciary Committee at 56, 61-62.

Debate on the Chandler Act followed. An early draft of Section 74 had permitted the extension of secured debts. In congressional hearings, Judge Charles Adams, a referee from the Northern District of Illinois and a participant in the legislative drafting process objected that those provisions would violate the Fifth Amendment and that the bankruptcy process of necessity needed to deal with secured creditors individually. Hearings on H. R. 8046 before the Senate Judiciary Committee, 75th Cong. 2d Sess., at 56. R. Preston Sealey, of the National Retail Credit Federation disagreed, arguing properly but unsuccessfully that Radford should only be applied to the extension of debts contracted to prior to the passage of a bankruptcy act. Hearings on H. R. 8046 before the Senate Judiciary Committee, 75th Conbg. 2d Sess., at 61-62. A subsequent draft which was to become Chapter XI was prepared by Reuben Hunt and Jacob Weinstein of the Commercial Law League and Watson Adair, chair of the National Association of Referees in Bankruptcy. In their report, they stated:

> The provision for the extension of secured debts is particularly unsound. Any interference with the free exercise by secured creditors of their remedies is bound ultimately to impair a liberal extension of credit.

Analysis of H.R. 12899, House Judiciary Committee print, 74th Congress, 2d Sess., p. 38 (1936).

The same National Bankruptcy Conference draft, in its report on Chapter XIII, went on to state:

> We have provided that the unsecured creditors be dealt with as a class, and that the acceptance of a plan by them be by a majority in number and amount of their claims; but in the case of the secured creditors, we have provided that each be dealt with individually...The provision for so dealing with secured creditors is made necessary by the decision of Louisville Joint Stock Land Bank v. Radford."

Analysis of H.R. 12899, House Judiciary Committee print, 74th Congress, 2d Sess., p. 38 (1936).

Earlier, on August 28, 1935, in response to the Radford decision, Congress passed a new Frazier-Lemke act, c. 792, 49 Stat. 943-945, 11 USCA §203 (s). The new act again dealt with pre-existing mortgages only and contained a number of significant impairments to the rights of the mortgage holder to enforce its mortgage. However, there was afforded a modicum of due process in the procedure. And the secured creditor was allowed to retain its lien. Brandeis again wrote for this Court which announced that the new Frazier-Lemke Act was now constitutional, *Wright v. Vinton Branch of Mountain Trust Bank of Roanoke*, 300 U.S. 440 (1937). The announcement appears to have been too late

to make any difference in the Chandler Act debate and drafts.

In its final version the Chandler Act Chapter XIII, §§601-686, left secured creditors virtually unaffected. P.L. 696, 52 Stat. 840-940, June 22, 1938. The treatment of secured debt under the Chandler Act reflects the chilling effect of the Radford decision. First, the Act excluded from the definition of "claims" all claims secured by estates in real property or chattels real, Article II, Definitions, §606 (1). Second, the act gave an absolute veto to secured creditors over confirmation of the plan of reorganization. Each secured creditor had to accept the plan before it would be confirmed. §652 (1).

Mature case law during the later Chandler Act period gave a secured creditor two options - to consent to its treatment or to file a petition for reclamation of the collateral, which would be granted. *See for example*, *In re O'Dell*, 198 F.Supp. 389 (D.Kans. 1961); *In re Copes*, 206 F.Supp. 369 (D.Kans. 1962); *but see In re Clevenger*, 282 F.2d 756 (7th Cir. 1960).

Congress then revisited the wage earner reorganization when it drafted the 1978 Bankruptcy Code. In its response to the Chandler Act Chapter XIII, in §§502, 506 (a), 1322 (b) (2), and 1325 (a) (5), Congress eliminated the right of a secured creditor to refuse to consent to the chapter 13 plan and in lieu of the right to reclamation gave the secured creditor the right to the cash equivalent of its collateral (including interest), §1325 (a) (5). All aspects of the secured debt contract were abrogated, the debt was novated to a new debt and to that novated debt Congress granted the debtor the ability to earn the defense of payment, §1325 (a) (5). For purposes of the statutory interpretation of Chapter 13, reference thereafter to the contract, the

contemplation of the parties in the transaction, the expectancy of the parties in the transaction, and the Fifth Amendment property rights of the secured creditor are inappropriate. Congress spelled out the entire bill of rights of the secured creditor in a chapter 13 in sections 1325 (a) (5), 506 (a) and 502.

It is the right of the secured creditor to reclaim and liquidate its collateral that the debtor must pay for. §1325 (a) specifically states with respect to non-consenting secured creditors that the debtor must either (1) obtain the secured creditor's treatment; (2) return the collateral to the creditor (the Chandler Act choices) or (3) pay the creditor's allowed secured claim. In the context of a chapter 13 reorganization, the net proceeds to the secured creditor on repossession and sale of its collateral--what it would have received if it would have foreclosed on the property--are what Congress intended to allow to the secured creditor. §506 (a).

For nearly twenty years now the system has adjudicated the §506 (a) value with little controversy. Certainly no one who ever consulted an automobile appraiser would encounter any valuation standard confusion.

III. Value and Appraisal

In addition to not being supported by the plain language of the statute, or the intent of the Congress in creating the Bankruptcy Code and Chapter 13 as a whole, there are two additional problems with the Petitioner's proposed standard that collateral be valued based on the retail cost the debtor would have to pay to replace the collateral. First the standard radically departs from traditional appraisal theory, appraisal as now federally regulated. *See BFP v. Resolution Trust Corp.*, 511 U.S. 531 (1994). Second, the standard rests on a segment of the market whose reported

values are universally recognized as unreliable.

Our courts have long dealt with the process of valuing property, See for example Texas Pattern Jury Charges PJC 203.01- "Present Value":

> The present value of an asset is its market value unless it has no market value.
>
> "Market value" is the price the asset will bring when it is offered for sale by one who desires to sell, but is not obliged to sell, and is bought by one who desires to buy, but is under no necessity of buying.

Texas Pattern Jury Charges 203.01, p. 203-3.

And appraisal of property has long been a recognized branch of the field of economics, See The Appraisal Institute, *The Appraisal of Real Estate*, (10th Edition, 1992), p. 18-22.

Recently, appraisal has become the subject of Federal regulation. 12 C.F.R. Part 34, Subpart C, §34.41 *et.seq.* The publication, *The Uniform Standards of Professional Appraisal Procedure*, recites an expanded definition of market value:

> A current economic definition agreed upon by agencies that regulate federal financial institutions in the United States of America is:
>
> The most probable price which a property should bring in a competitive and open market under all conditions requisite to a fair sale, the buyer and seller each acting prudently and knowledgeably, and assuming the price is not affected by undue stimulus.

Uniform Standards of Professional Appraisal Practice, The Appraisal Standards Board (1995 Edition), p. 7-8; *See* 12 C.F.R. §34.42(g).

USPAP95 also recites a definition of appraisal:

> APPRAISAL: (noun) the act or process of estimating value, an estimate of value.

Uniform Standards of Professional Appraisal Practice, The Appraisal Standards Board (1995 Edition), p. 7.

A. Appraisal of Personal Property

Appraisal is a recognized branch of economics. The Appraisal Institute has defined appraisal:

> Appraisal is defined as the act or process of estimating value.

The Appraisal Institute, *The Appraisal of Real Estate* (10 th Edition, 1992), p. 10.

While his treatise was a summary of the state of the discipline as it existed at the time of the initial publication of the treatise, it is generally accepted that the treatise by James Bonbright entitled *Valuation of Property* is the font of modern appraisal theory. Bonbright, J., *Valuation of Property* (Michie Co., 1937, reprinted 1965).

Bonbright is the first to break out the three currently recognized techniques for appraising property. *Ibid.*, at 53,54. His terminology was "sales" (now comparables), *Ibid.*, chapter VII, p. 127-149, replacement, *Ibid.*, chapters IX and X, p. 150-215, and income, *Ibid.*, chapter XI, p. 216-232.

The academic work has not stopped there. Two significant private academic bodies, the Appraisal Institute in Chicago and the Institute of Property Taxation in Washington, D. C., both publish periodically treatises which update appraisal theory as it develops. See The Appraisal Institute, *The Appraisal of Real Estate* (10th Edition, 1992). The American Society of Appraisers publishes the periodical *Valuation*, containing monographs in different appraisal topics. Texas A&M University maintains an Appraisal Institute on its College Station, Texas, campus.

Appraisal is not just an academic discipline. Because the concept of value is so fundamental to the American economy, appraisal is a significantly regulated activity.

Earlier, in 1978, Congress established the Financial Institutions Examination Council to prescribe uniform principles and standards for the Federal examination of financial institutions. 12 U.S.C. §3301 et seq. This statute created the Appraisal Foundation as the source of appraisal standards and qualifications. 12 U.S.C. §3333 (b).

It was the specific belief of Congress that the savings and loan disaster in the United States was attributable in part to a failure on the part of the financial, judicial and regulatory communities to properly define, regulate and police the appraisal activity. So, in 1989, as a part of the Financial Institutions Reform, Recovery and Enforcement Act of 1989, Congress created the Appraisal Subcommittee of the Council generally to monitor appraisal standards in the States, 12 U.S.C. §3333 (a), but specifically to monitor and review the practices, procedures, activities and organizational structure of the Appraisal Foundation. 12 U.S.C. §3333 (b). The Appraisal Foundation had established an ad hoc committee to promulgate the *Uniform Standards of Professional Appraisal Practice* in 1986. In 1989, as a result

of the FIRREA amendments, it formed the Appraisal Standards Board to formally monitor and revise these standards over time. In 1989 the Board formally adopted the Foundation's *Uniform Standards of Professional Appraisal Practice* and has since that time revised and republished them from time to time, the last edition being the 1995 edition.

Congress contemplated a joint federal/state effort. In order to perform an appraisal for a federally insured institution, the appraiser must have a state appraisal license. 12 U.S.C. 3333. Few states had an appraisal licensing scheme however. So virtually all states then created licensing boards so their appraisers could qualify to perform appraisals for federally insured institutions. *See* Vernon's Ann.Civ.Stat. art. 6573a.2 (the "Texas Appraisal Licensing and Certification Act"). The states then generally picked up USPAP as the official source of canons of ethics and statements of procedures for those desiring to obtain and maintain an appraisal license. So, for example, the most recent edition of the *Uniform Standards of Professional Appraisal Practice*, 1995, has been adopted by the Texas Board of Appraisal Licensing and therefore constitutes State as well as Federal regulation.

It is a mistake to assume that the regulatory effort has been aimed at real estate appraisal. Two of the ten standards, Standard No. 7 and Standard No. 8, are specifically directed to the appraisal of personal property. *Uniform Standards of Professional Appraisal Practice*, The Appraisal Standards Board (1995 Edition), p. 43-49.

The Preamble to the Uniform Standards clearly states the Standards "...contain binding requirements..."., *Uniform Standards of Professional Appraisal Practice*, The Appraisal Standards Board (1995 Edition), p. 1.

Appraisal theory is applicable to the valuation of all types of property, whether real or personal, tangible or intangible. Bonbright, J., *Valuation of Property*, op. cit., at 13, 53-54 (Michie Co., 1937, reprinted 1965). The principles and methodology are identical, regardless of the type of property being appraised, while obviously some issues may be more important than others in context. Ibid, at 13, 53-54. USPAP95 Standards Rule 7-3 (e) mandates the appraiser use the cost, income and sales comparison approaches in appraising tangible personal property. *Uniform Standards of Professional Appraisal Practice*, The Appraisal Standards Board (1995 Edition), p. 44-45. A great deal of Bonbright's treatise is devoted to the valuation of railroad rolling stock, an important issue in the early 1930's. Bonbright, J., *Valuation of Property*, *op. cit.*, at 150-215 (Michie Co., 1937, reprinted 1965).

The Appraisal Institute has defined the three traditional approaches:

> In assignments to estimate market value, the ultimate goal of the valuation process is a well-supported value conclusion that reflects all the factors that influence the market value of the property being appraised. To achieve this goal, an appraiser studies a property from three different viewpoints, which correspond to the three traditional approaches to value.
>
> 1. The current cost of reproducing or replacing the improvements, minus the loss in value from depreciation, plus site value--the cost approach.
>
> 2. The value indicated by recent sales of comparable properties in the market--the sales comparison approach

3. The value of a property's earning power based on the capitalization of its income--the income capitalization approach.

The Appraisal Institute, *The Appraisal of Real Estate* (10th Edition, 1992), p. 71.

The income capitalization approach locates an income stream generated by the property, quantifies that stream and discounts that stream to present value. The theory inherently holds that the value of the property is determined solely by the income it generates. See The Appraisal Institute, *The Appraisal of Real Estate* (10 th Edition, 1992), chapters 18-22, pp. 408-551. It is appropriate in those cases where the property generates significant, stable income over extended periods of time, usually the useful life of the property being valued, and other properties are only marginally comparable. It is inappropriate if no stable income stream can be quantified. See David P. Doan and Richard A. Southern, "Economic Life in Appraising Leased Equipment: Role of Market Value and Capitalization of Income," *ASA Valuation*, (January 1990), p. 82.

Income generating real estate, apartments, hotels, office buildings, are more often than not appraised using the income method. *See* The Appraisal Institute, *The Appraisal of Real Estate* (10 th Edition, 1992), chapter 18, pp. 408-427.

The cost, or replacement cost, approach takes the cost of purchasing a new, similar item and then subtracts from that sum depreciation on the property being valued. The Appraisal Institute, *The Appraisal of Real Estate* (10 th Edition, 1992), p. 80. It is appropriate where precise determination of new cost can be determined, the property is likely to generate income but has not yet done so, comparables cannot be located, and depreciation is more often than not negligible. The Appraisal Institute, *The Appraisal of Real Estate* (10 th Edition, 1992), chapters 14, 15 and 16, pp. 312-365.

For example a newly constructed factory would be appraised at replacement cost. Inventory is more often than not appraised at replacement cost.

Properly, contrary to the argument of the Associates, the replacement cost approach does not seek values for substituted equivalents. *See* Pet. Brief, p. 22. The Fifth Circuit panel opinion in this case made that same semantic and terminology mistake. They coined the phrase "replacement value". *In re Rash*, 31 F.3d 325, 326 (5th Cir. 1995). The Associates goes on to say that "replacement value" is the cost the debtor would incur to replace the collateral. Pet. Brief, p. 22. See also U.S. Brief, pp. 11-13. That definition can't be found anywhere in the literature. Interestingly enough, the Associates claims one should not hypothesize a foreclosure when none is contemplated. Pet. Brief, p. 13. It then hypothesizes a retail purchase when none is contemplated. Pet. Brief, p. 22. In fact, the Associates was advocating the use of the comparables method then seeking a mandate to use of the retail market as the pool of comparables, their "relevant 'market'", Pet. Brief, p. 22. It is axiomatic in the true replacement cost method that in the real world the owner would not seek out an exact substitute but would instead purchase the newest available and that an allowance must be made for the distinction between new and the item being valued. C.H. Donias, "Appraisal of Major Mechanics and Equipment," *ASA Valuation* (November 1951), p. 84. For example, the Appraisal Institute defines replacement cost as follows:

> Replacement cost is the estimated cost to construct, at current prices as of the effective appraisal date, a building with utility equivalent to the building being appraised, using modern materials and current standards, design and layout.

The Appraisal Institute, *The Appraisal of Real Estate* (10 th Edition, 1992), p. 319.

The allowance utilized to adjust the value is depreciation. *See* Appraisal Institute, The Appraisal Institute, *The Appraisal of Real Estate* (10 th Edition, 1992), p. 320.

The comparables method looks at the market place and determines whether equivalent properties are being routinely bought and sold and whether a price for those sales can be determined. It is appropriate if there is a ready market for the property in the vicinity of the property being valued and the property is not generating a significant, stable income unique to that property and not to the property in the market in general. It is inappropriate if the property being valued has for whatever the reason an ability to generate income over and above what similar property is then generating. *See* The Appraisal Institute, *The Appraisal of Real Estate* (10 th Edition, 1992), chapter 17, pp. 366-407.

Virtually all residential real property, all securities traded on national and large regional public markets, and most interchangeable manufacturing equipment are valued using the comparables method.

In using the comparables methodology, the appraiser is charged with selecting the appropriate market. Here, a distinction can be made between the appraisal as an adjudication and the appraisal as a predictor. So for

example, if a bankruptcy trustee proposes to auction collateral, and the secured creditor objects, claiming the auction will not produce a distribution above and beyond the lien to the unsecured creditors, one would expect that the appraisers employed by the parties choose those comparable sales produced by auctions, a process generally referred to as auction appraisal. *See* , Miles, Leslie and Bealmear, Allen, "Auction Value, Machinery and Equipment Appraisals" *ASA Valuation*, vol. 24, Number One, p. 42 (December 1977). Similarly, an automobile dealer might take a bankruptcy and as a part of its §1129 (a) (7) liquidation analysis produce a valuation of its inventory. The appraiser there may well choose the retail market as the most appropriate range of comparables. The choice of the market is a choice of which comparables are truly comparable.

The Rash's appraiser did use the comparables method. He referred extensively to reported sales of the truck on the open market and did not discount those reported values. The wholesale market is not totally populated by lenders selling collateral at foreclosure, *See* Pet. Brief, p. 22.

Other appraisal methods can be used. If for example, the property to be sold carried with it a significant income stream, a party bidding at the auction would be aware and price its bid accordingly and so even if an auction is proposed, the income method may still be the appropriate methodology.

The decision as to the appropriate method is one of the key elements in forming the value opinion. USPAP95 Standards Rule 7-3 states the appraiser must:

> (e) consider the cost, income, and sales comparison approaches and their degree of applicability in the valuation of personal

property. The selection of valuation approaches to be used should be based on the availability of data and the purpose of the appraisal;

Uniform Standards of Professional Appraisal Practice, The Appraisal Standards Board (1995 Edition), p. 45.

The process of selecting the proper methodology is referred to as reconciliation, and it involves three factors, the appropriateness of the methodology, the accuracy of the methodology and the quantity of evidence available to the methodology. The Appraisal Institute, *The Appraisal of Real Estate* (10 th Edition, 1992), pp. 555-558. The Appraisal Institute goes on to state:

> The final value estimate is not derived simply by applying technical and quantitative procedures; rather, it involves the exercise of judgment.

The Appraisal Institute, *The Appraisal of Real Estate* (10 th Edition, 1992), p. 558.

There is very little dispute among appraisers about how to appraise a truck. All the previously discussed principles of appraisal directly apply. First, all appraisals start with an extensive physical examination of the vehicle in question. *See Uniform Standards of Professional Appraisal Practice*, The Appraisal Standards Board (1995 Edition), Standards Rule 7-3 (f), p. 45. The specific items to be examined are outlined in the proposed valuation form published by *The Truck Blue Book*, a private publication of Maclean Hunter Market Reports, Inc., and the reference used by The Rashes' appraiser. *The Truck Blue Book*, Maclean Hunter Market Reports, Inc., p vii. The Rashes' appraiser followed this form.

For comparables information the appraiser may then refer to the published lists but it is clear that the published list should only be a reference point and should not be the exclusive reference point. *The Truck Blue Book* is regarded as the more authoritative of the "Blue Books", the other being the National Automobile Dealers Association *Heavy Truck Blue Book*. Five or six trade magazines, including, for example, *Truck Market News*, a Dallas, Texas publication of Specialty Marketing Corporation, publish both national and regional truck prices on monthly or quarterly bases. The Rashes' appraiser consulted all of those available publications.

In all cases, no appraiser ever relies on any of these publications. For one thing, these publications are quite inconsistent in their reporting. NationsBank, in a footnote, states that the NADA guide reports wholesale and retail values. NationsBank Brief, footnote 9, p. 15. The Eastern edition does. This publication was used by the Valenti court, *In re Valenti*, No. 95-5079, 1997, U.S.App. LEXIS 647, *10 (2nd Cir. January 15, 1997). And apparently the Irvine, California *Kelly's Blue Book*, an NADA publication does also. But the Southwestern edition, covering Arkansas, Louisiana, Oklahoma and Texas, uses retail and loan values and specifically refers appraisers to the national *NADA Wholesale Guide*, which reports national wholesale values only. NADA publications are private, none are truly "official", all change with time, and all are prepared by the retail auto industry, a classic example of the fox guarding the henhouse.

A physical inspection, constant contact with the market, constant review of a number of periodicals and market reports, extensive experience, and a specific knowledge of the purpose of the appraisal, the proposed use of the vehicle and the interest being appraised are all

essential components of a proper, ethical appraisal.

Had, as the Associates suggests this Court should hold, the bankruptcy court insisted on the use of the "replacement method", the replacement cost value of the Kenworth, properly calculated by depreciating a 1992 Kenworth, would have been $29,480, a sum significantly lower than the value used by the Rashes.

The Associates seems to want to argue that Mr. Rash's truck has "going concern value". Again this is a mishandling of basic terminology. An ongoing business can be valued as an entity ("going concern value") or its individual assets can be broken out and valued individually ("liquidation value"), *See* The Appraisal Institute, *The Appraisal of Real Estate* (10 th Edition, 1992), p. 23-24.

The Associates was really suggesting the employment of the income methodology to appraise the truck. Respondent has already suggested that when an income stream is unstable that methodology is inappropriate, but we have a golden opportunity here to reconstruct an income appraisal retrospectively since we know for sure all income this truck did derive during the course of the repayment.

The Associates attempts to apply income methodology to the appraisal of the truck but leaves out a key cost component. Mr. Rash was not just leasing his truck to Lane and Lane was not just paying lease payments for his truck. Mr. Rash was leasing an operated truck to Lane and Lane was paying for the truck to haul goods and the driver to drive the truck.

Now we know that Mr. Rash was the designated driver. An economist or "going business" appraiser, in applying the income method to the proposed revenue stream

($3,725.00 per month or average about $900 per week) would first calculate total revenues and then deduct from those revenues two expense categories, first the expenses of maintaining the truck ($400 per month or roughly $100 per week) and then a reasonable payroll cost for the driver.

There is ample evidence of reasonable payroll cost. The National Master Freight Agreement between national freight haulers and the International Brotherhood of Teamsters calls for a wage of $17.00 per hour or $.42 per mile. Using the per hour wage as a cost factor causes the truck to have a negative "going concern value". The calculation gets no better when you use the mileage value. Mr. Rash drove about 549,000 miles during the fifty-eight months of his plan or approximately 2,400 per week. Again the truck has a negative "going concern value". In fact, if you reverse the procedure and calculate the wage Mr. Rash would have earned per hour assuming that he was required to pay to petitioner the amount they claim is the "going concern value" of the truck, you would come up with approximately $6.20 per hour. That is not a reasonable wage component in the calculation.

The Associates argues that the proposed use of the property is important, citing §506 (a). The proposed use of the property can be important in some §506 (a) adjudications. USPAP95 Standards Rule 7-2 states:

> In developing a personal property appraisal, an appraiser must consider the purpose and intended use of the appraisal and observe the following specific appraisal guidelines:
>
> (a) adequately identify the property to be valued including the method of identification;

(b) define the purpose and intended use of the appraisal including all general and specific limiting conditions;...

(d) select and define the value to be considered consistent with the purpose of the appraisal;

(e) collect, verify, analyze and reconcile such data as are available, adequately identified and described, to indicate a value conclusion;...

Uniform Standards of Professional Appraisal Practice, The Appraisal Standards Board (1995 Edition), p. 44.

Property use is an extremely active topic in real estate appraisal but all property is affected by the concept. In analyzing use, the appraiser can look either to the actual use at the time of the appraisal or to a theoretical use being proposed.

In discussing the concept of use value, the Appraisal Institute states:

> Court decisions and specific statutes may also create the need for use value appraisals. For instance, many states require agricultural use appraisals of farmland for property tax purposes rather than value estimates based on highest and best use.

The Appraisal Institute, *The Appraisal of Real Estate* (10 th Edition, 1992), p. 22.

From this concept arises the principle of highest and best use. The best perspective to study this concept is real estate. A farmer is farming a tract. That tract has a certain value as farmland. It is located near a metropolitan area. In

fact the land may have a much greater value as development property.

The Appraisal Institute has developed a definition of highest and best use:

> Highest and best use may be defined as:
> the reasonably probable and legal use of vacant land or improved property, which is physically possible, appropriately supported, financially feasible, and that results in the highest value.

The Appraisal Institute, The Appraisal of Real Estate (10 th Edition, 1992), p. 45.

Congress did take a legislative position on the issue in §506 (a). 506 (a). All property is to be valued at the proposed use. 11 U.S.C. §506 (a). So again, in a chapter 12, if the farmer is proposing to farm a tract, it is appraised as farm land, even though it may have a higher development value.

But use isn't an issue in this case. The truck was proposed to be used to haul over the highway freight. The Rashes' and the Associates experts both knew that was the proposed use. That is how the vehicle was to be valued. That is how Steven Thibodeaux appraised it.

B. The Retail Market - an Unrealiable Source of Market Information

In connection with vehicles generally including trucks, this Court should be aware that the use of retail value is virtually never used by appraisers to any major degree must less given dispositive weight. The reason for that first lies in the definitions NADA gives to the two lists as it collects

the data. The retail list is compiled only using those NADA members who choose to report. It is compiled solely for the interest of its members as to how much they might try to mark up a vehicle to obtain a price in excess of its base worth. The wholesale list is the report of appraisers and voluntary auctions conducted throughout the country. Voluntary auctions always have been and always will be the most reliable source of willing buyer, willing seller information since they literally are calling together willing buyers and willing sellers with no predetermination as to price to be paid. NADA actually advises appraisers to use its national wholesale publication and not its regional retail publication.

The second reason is that the retail value does not reflect the vehicle being valued. It is actually the vehicle with enhancements of tremendous variation such as oil and filter changes, clean ups, in-house financing and warranties, repairs, the float associated with the length of time to sale and other items which do not show up in any itemization in the retail list but which nonetheless do significantly affect the net price obtained on sale. The Fifth Circuit *en banc* strongly emphasized this point, Pet. p. 30a-32a. The Associates concedes these facts in its brief. Pet. Brief, p. 23. Even "as-is" vehicles are enhanced in value in that their sale is generally covered by state "lemon" laws, *See* Vernon's Ann.Civ.Stat. art. 4413 (36).

In-house financing is an exceptionally significant issue. The Federal definition of market value requires that the transaction be a cash transaction, 12 C.F.R. §34.42 (g)(4). Amicus Chase Manhattan Bank, in its brief, admits that the bulk of its automobile loan portfolio is generated at the used care lot level. NationsBank Brief, p. 3. There has been an opportunity to scrutinize this industry recently. In the autumn of 1996, Mercury Finance, one of the nation's

largest purchasers of automobile paper in the secondary market filed a two billion dollar bankruptcy, largely related to growing litigation over the question of hidden finance charges and usury. This phenomenon was reported in the *Wall Street Journal* on February 5, 1997, under the heading "A Lemon of a Deal: Used-Car Lender Leaves a Sour Taste" by Jeff Bailey and Thomas Burton.

The article points out that, although an individual might pay fifteen to seventeen per cent interest to purchase a used car at a used care lot, the presence of in-house financing enables that lot to double and even triple the purchase price of the vehicle. That increased principal is literally hidden "points". Bailey, Jeff and Burton, Thomas, "A Lemon of a Deal: Used-Car Lender Leaves a Sour Taste," *Wall Street Journal*, February 5, 1997, p. 1.

These abuses are well known and cause few appraisers to seriously rely on reported retail sales.

C. The Breadth of §506 (a).

The Associates,, its amicus, and a number of courts writing on the topic seem to automatically assume that replacement value will always be higher than wholesale value. For example, the Fifth Circuit panel majority based its holding on a hypothesis that replacement value will always be higher than wholesale value. Matter of Rash, 63 F.3d 685, 692 (5th Cir. 1995). To the extent that the Court mandates replacement rather than real world values, it cultivates the potential for some gruesome outcomes.

1. Replacement value can be less than wholesale value. In a significant number of industries, for example computers, computer parts, and all other high technology, replacement value is generally less than wholesale value. Debtors in

those industries can reap windfalls. IBM leased on a three-year guaranteed lease basis to Gulf States Utilities a mid-frame computer. The lease payments created a net present value for the system of approximately $100,000.00. As is traditionally the case with computers, all of the computing power represented by IBM's machines could be replaced today in the retail computer market for approximately $15,000 to $20,000. Can a debtor in IBM's circumstances argue it should retain the lease and pay the secured creditor, whose collateral is the computer, only the $15,000 to $20,000 represented by "retail value"?

2. Replacement value can be measurably larger than wholesale value. Income generating real estate, apartments, office buildings, resorts, hotels, etc., rarely appraise at replacement value because that value is skewed unrealistically high. But high values, while they arguably benefit undersecured creditors, are a threat to over-secured creditors. Secured creditors holding first mortgages on those income-generating real estate properties commonly are oversecured. They can't get the advantage of the extra security in pay back because they are limited to their notes. The equity cushion prevents them from lifting the stay or receiving adequate protection payments. They are exposed to §364 superpriority, super lien loans. And in both chapter 11 and chapter 12 they are subjected to collateral dilution through lien stripping. Remember, the great savings and loan crash of the 1980's, the Resolution Trust Corporation, and the mandatory licensing of appraisers all grew out of overly optimistic, not overly pessimistic, appraisals. Chapter 7 trustees can seize and sell more collateral because arguably there is now estate equity in the collateral. And marginally secured creditors in chapter 11 proceedings will lose the tactical advantage of the §1111 (b) election.

c. In either case the trial of real estate values will be gutted. The three-method appraisal and its reconciliation, the key piece of testimony in the trial of real estate values, would be superfluous and even prohibited. Similarly there would appear to be no room for true business entity valuation since those valuations are strictly income method capitalizations, rather than replacement value calculations.

SUMMARY AND PROPOSED HOLDING

By way of summary, the Rashes would propose the following holding in disposition of this case:

The finding by the bankruptcy court that The Rashes' 1989 Kenworth truck had a value of $31,875.00 was not clearly erroneous. The judgment and order of the bankruptcy court is affirmed.[5]

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[5] All parties agree that the basic rights of a secured creditor unless otherwise dealt with by Title 11 are to be determined by reference to state law, See Pet. Brief, p. 25 citing *Nobleman v. American Sav. Bank*, 508 U.S. 324, 329 (1993). The basic right of the secured creditor is to be "paid in full" [emphasis sic], Pet. Brief p. 25. In fact, under Texas law, a lien on a motor vehicle is governed by the general law of mortgages, Vernon's Ann.Civ.Stat. art. 6687-1, §§3, 5,6. In Texas, a mortgage is extinguished when paid and has no independent existence from the underlying debt. *O'Dell v. First Nat. Bank of Kerrville*, 855 S.W.2d 410 (Tex. 1993); *Texas Bank & Tr. Co. of Dallas v. Custom Leasing*, Inc. 402 S.W.2d 926, 930 (Tex.app. Amarillo 1966); *Southland Life Ins. Co. v. Barrett*, 172 S.W.2d 997, 1001 (Tex.App.Ft.Worth 1943); *American Type Founder Co. v. First Nat. of Teague*, 156 S.W. 300, 301 (Tex.App. Austin 1913). Petitioner confirms this in its brief, Pet. Brief, p. 25-28. The bankruptcy court order affirmed by the Fifth Circuit *en banc*, clearly established the sum of money required to pay the debt in full, $39,426.66, Jt. App. p. 98. This is now the total debt, as the bankruptcy court clearly had the authority to novate that debt. Petitioner appealed that order but unsuccessfully and the Fifth Circuit issued its mandate enforcing that order. That mandate has never been stayed and the

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bankruptcy court order has never been stayed. On compliance with that order and the making of the 58th payment called for by the order and their plan, the Rashes paid in full the debt. Under Texas law at that point in time with no further action required by the Rashes the lien was extinguished. If this case is remanded to the bankruptcy court, the Rashes intend to make that argument at that time and note the argument here to preserve it.

(18)

No. 96-454

IN THE
Supreme Court of the United States

OCTOBER TERM, 1996

ASSOCIATES COMMERCIAL CORPORATION,
Petitioner,

v.

ELRAY RASH AND JEAN E. RASH,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

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REPLY BRIEF OF PETITIONER

Petitioner respectfully submits this reply to the briefs filed by respondents and their *amici curiae*, the National Association of Consumer Bankruptcy Attorneys, Inc. ("NACBA") and the National Association of Chapter Thirteen Trustees ("NACTT").

STATEMENT OF FACTS

In a recitation that is virtually devoid of any support in the record, respondents depict their chapter 13 case as a success that would not have been possible under petitioner's interpretation of the Code. Of course, the relevant legal issue is the meaning of the phrase "proposed disposition or use" in 11 U.S.C. § 506(a) and that issue does not turn on any facts specific to respondents. But even taking respondents' assertions at face value,[1] it is

---

[1] Much of respondents' factual recitation is not just unsupported by the record, but wrong. One particular point merits a response. Respondents assert that they did not want to surrender the truck because they "had too much equity in it to just give it up." Resp.

apparent that Mr. Rash's trucking business suffers from fundamental economic flaws that no chapter 13 plan could cure, except temporarily.

The plan allowed respondents to reduce their monthly payments on the truck loan from $1,610 to $680. Jt. App. 93. Yet, even with that relief, they have barely managed to scrape by. Respondents say they would not have been able to pay the extra $215 a month that would have been required under petitioner's interpretation of the statute. Resp. Br. 13. If that is true, Mr. Rash's business is doomed in any case because he now needs to replace the truck (*id.*), which will require him to make loan payments that are far more than he is now paying.

Thus, the chapter 13 plan has merely postponed the demise of Mr. Rash's trucking business, and in the meantime he has earned much less than the prevailing union wage, *id.* at 39, which he could have received had he gone to work for someone else as a truck driver rather than trying to maintain his own business. In short, Mr. Rash's chapter 13 case cannot be characterized as a success from the debtor's standpoint, and certainly provides no policy justification for deciding this case in a manner that favors debtors at the expense of secured creditors.

ARGUMENT

THE BANKRUPTCY CODE REQUIRES A REPLACEMENT VALUATION OF COLLATERAL THAT THE DEBTOR PROPOSES TO RETAIN AND USE

There is no disagreement among the parties and *amici* on two key points. First, the value of an asset depends upon its proposed disposition or use. Property is generally

Br. 5. The bankruptcy judge, however, expressly found that "Debtor does not have equity in the truck." Pet. App. 119a. Indeed, the issue presented in this case can only arise when the debtor has no equity in the collateral. If the collateral is worth more than what the debtor owes, then the Bankruptcy Code requires full payment.

worth more to a debtor who uses it than to a creditor who must dispose of it. This difference in value is well recognized in the "blue books" discussed in the briefs, and in the appraisal principles cited by respondents.[3] Second, there is a consensus that the Seventh Circuit's "split the difference" rule does not reflect any recognized valuation standard and is not a plausible interpretation of the Bankruptcy Code.

What is most striking about the briefs of respondents and their *amici* is the unwillingness to defend the essential reasoning of the decision below. They have abandoned the central premise of the court of appeals' holding, which is that § 506(a)'s language "must clearly compel" the result petitioner proposed. Pet. App. 10a. Petitioner demonstrated that its interpretation of § 506(a) did no violence to state law and that, to the contrary, it was the holding below that broadly cut back on the state law right of secured creditors to be paid in full. Pet. Br. 25-27. Respondents and their *amici* effectively demonstrate the fundamental flaw in the court of appeals' approach by abandoning completely any reliance on a clear statement requirement.[4] Moreover, they simply ignore the remaining problem: It is they who seek to modify petitioner's state law rights and therefore it is they who must demonstrate that this proposed result is compelled by the language of the statute. Of course, that

[3] *See* Appraisal Standards Board, *Uniform Standards of Professional Appraisal Practice*, Standards Rule 7-3, at p. 73 (1996 ed.) ("personal property has several measurable marketplaces, and the appraiser must identify, define, and analyze the appropriate market consistent with the purpose of the appraisal"). The official comment to this rule points out that "a property may have distinct value at a wholesale level of trade, a retail level of trade, or . . . under varying auction conditions."

[4] The Fifth Circuit relied heavily upon *BFP* v. *Resolution Trust Corp.*, 511 U.S. 531 (1994). Pet. App. 9a-10a. Tellingly, respondents only cite *BFP* with respect to federal regulation of appraisals; the NACBA cites the case twice with respect to the meaning of fair market value; and the NACTT does not cite the case at all.

is a burden they never accept, much less come close to satisfying.

Given the common ground between the parties and respondents' effective concession that the court of appeals' central premise is insupportable, it becomes plain that petitioner's proposed interpretation of § 506(a) is unquestionably correct. Indeed, its interpretation is completely faithful to the language of the statute, and none of the arguments offered by respondents or their *amici* remotely justifies interpreting § 506(a) to restrict the value of the collateral retained and used by the debtor by treating it as if the debtor had surrendered the property. *A fortiori*, nothing they argue compels such a conclusion.

A. Respondents' Interpretation of § 506(a) Ignores the Congressional Directive That Value Depends on the "Proposed Disposition or Use"

The decisive issue in this case is what Congress meant when it declared in § 506(a) that "value shall be determined in light of . . . the proposed disposition or use of such property." The most natural—indeed, the only sensible—reading is that bankruptcy judges should select the measure of value that corresponds to "the proposed disposition or use."

Respondents reject this straightforward interpretation of the statute, but neither they nor their supporters have been able to give this phrase any other cogent meaning. Petitioner has already demonstrated the fallacies in the Fifth Circuit's attempt to give meaning to this phrase. Pet. Br. 15-16. Respondents' *amicus* agrees that the Fifth Circuit's attempt to give the term "use" some meaning—by suggesting that it instructs courts to adjust value for uses involving rapid depreciation—is contrary to the structure of the Code and fundamental concepts of value. See NACBA Br. 16-17. Respondents try to give this phrase meaning by stating that valuation should reflect the use of the truck *as collateral*. Resp. Br. 16. This

reading of "use" is not only most unnatural, but virtually meaningless. Collateral is *always* used as collateral—and § 506(a) clearly treats "proposed . . . use" as a variable, not as a constant.

The NACBA offers a different explanation. In its view, Congress adopted the "proposed disposition or use" language to address a valuation issue that sometimes arises with farmland—whether the property should be valued based on its *actual* agricultural use or its *highest and best* use if developed. NACBA Br. 14. Although there is a split of authority on this point, *neither* line of cases suggests that the creditor's recovery is limited to what it could obtain by foreclosing on its mortgage; under both approaches, the secured creditor is entitled to receive *at least* what the debtor would have to pay to purchase similar land used for the same purpose.[4] In any event, Congress surely was not focusing on this esoteric valuation issue when it adopted § 506(a). Instead, it was attempting to give courts guidance on the more fundamental question of when a liquidation standard is appropriate and when a going concern or fair market value standard should be chosen. See Pet. Br. 39-40.

B. Respondents' Strained Interpretation Is Not Needed to Give Meaning to the Phrase "Creditor's Interest"

Respondents attempt to justify giving short shrift to the "proposed disposition or use" language of § 506(a) by arguing that petitioner's interpretation ignores the phrase "creditor's interest." As the NACBA puts it:

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[4] *Compare, e.g., In re Foster*, 79 B.R. 906, 908 (Bankr. D. Mont. 1987) (requiring debtor to pay the "fair market value" of comparable farmland, rather than the higher value of the land if subdivided) *with Speck* v. *United States* (*In re Speck*), 104 B.R. 1021, 1023-24 (D.S.D. 1989) (requiring the debtor to pay "the fair market value of the property; i.e., 'the price which a willing seller under no compulsion to sell and a willing buyer under no compulsion to buy would agree upon after the property has been exposed to the market for a reasonable time' ").

> The "creditor's interest" can have no meaning if the debtor's interest is the interest being measured. If Congress had intended the secured claim to be measured by the value to the debtor of retaining or using the vehicle, Congress could have simplified § 506(a) to read "an allowed secured claim of a creditor . . . is a claim to the extent of the value of the use to the debtor of the property securing the claim."

NACBA Br. 3.[5]

This argument mischaracterizes petitioner's position. Associates is not arguing that collateral should *always* be valued from the debtor's perspective.[6] If the collateral is surrendered, then the valuation should indeed be based on what the creditor could obtain. For that reason, the "simplified" phraseology that the NACBA suggests would not have sufficed given the range of cases that Congress needed to address.[7] Under petitioner's interpretation, by contrast, the phrase "creditor's interest" serves two important purposes. First, it clarifies that the creditor's secured claim cannot exceed the amount of the debt even

[5] Of course, this language would not satisfy respondents, who still would argue that "use" means use as collateral. This is still unnatural, but it casts doubt on *amicus*'s assertion that its approach is either simpler or more effective than Congress's.

[6] This is why Congress did not use the term "debtor's interest" in § 506(a). Thus, the failure to incorporate that term, which the NACBA notes appears elsewhere in the statute, does reflect a purposeful choice, just not the one the NACBA asserts (Br. 11). Instead, Congress merely declined to value property the same way in all cases; valuation depends upon the disposition or use of the property in each case.

[7] The NACBA erroneously states that "if the debtor elects to surrender the property through the Chapter 13 plan no judicial valuation of the secured claim is undertaken at all." NACBA Br. 6. In reality, however, a judicial valuation of the collateral value is needed to determine the amount of the creditor's *unsecured* deficiency—at least in those cases where the creditor has not yet sold the collateral. *See* § 506(a) (amount of claim in excess of collateral value is an unsecured claim).

if the collateral is worth more.[8] Second, this phrase is necessary because, as even the court below recognized, "[t]he creditor's lien may only be a partial lien or it may be junior to other liens also secured by the estate's interest in the property." Pet. App. 13a.

Recognizing that its interpretation of the phrase "creditor's interest" is at odds with this Court's interpretation, the NACBA goes to great lengths (NACBA Br. 8-10) to argue that the Court did not mean what it plainly stated, when it observed in *United Savings Ass'n* v. *Timbers of Inwood Forest Assocs.*, 484 U.S. 365 (1988), that the first sentence of § 506(a) requires a valuation of the collateral, and not a valuation of the creditor's lien. Although there is no reason to believe, as *amicus* proposes, that the Court was confused, *amicus* completely ignores the other prior decisions of this Court that reach exactly the same conclusion. See Pet. Br. 31-32 (citing *United States* v. *Ron Pair Enters., Inc.*, 489 U.S. 235, 239 (1989); *Nobelman* v. *American Sav. Bank*, 508 U.S. 324, 328 (1993)). In fact, the distinction that this Court drew in *Timbers* was central to the holding.

Timbers resolved a conflict among the circuits about the rights of an undersecured creditor when the automatic stay prevents it from foreclosing during the pendency of a bankruptcy case. Section 361 provides that the creditor is entitled to adequate protection "to the extent that the stay . . . results in a decrease in the value of such entity's interest in such property." The issue in *Timbers* was whether adequate protection requires the payment of interest to compensate the creditor for the delay in exercising its foreclosure rights. The Ninth Circuit had allowed such compensation, and it reached that result by drawing a distinction between (1) "the creditor's interest"

[8] If this phrase were omitted, § 506(a) would state that the creditor has "a secured claim to the extent of the value of the estate's interest in such property"—which may exceed the amount of the debt.

arising from its lien, and (2) the property serving as collateral. In the Ninth Circuit's view, § 361 protected "the secured creditor's interest and not merely the value of the collateral." *Crocker Nat'l Bank* v. *American Mariner Indus., Inc. (In re American Mariner Indus., Inc.)*, 734 F.2d 426, 430 (9th Cir. 1984).

This Court, however, adopted a different interpretation of the statutory phrase "value of such entity's interest in such property." The Court held that this phrase refers to the value of the underlying collateral, and *not* to the value of the bundle of rights a creditor has by virtue of its lien. In reaching this conclusion, the Court pointed out that § 506(a) contains essentially the same phrase, and should be interpreted in the same manner. "The phrase 'value of such creditor's interest' in § 506(a) means 'the value of the collateral.'" *Timbers*, 484 U.S. at 372 (quoting H.R. Rep. No. 95-595, at 181, 356 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6141, 6312). In short, the first sentence of § 506(a) requires bankruptcy judges to determine the value of the property subject to the lien, not the value to the creditor of having a lien.[9]

[9] The NACBA also suggests (Br. 10) that this Court endorsed a foreclosure value standard in *Timbers* because the opinion mentioned the fact that the bankruptcy judge had "conditioned continuance of the stay on monthly payments [of interest] . . . on the estimated amount realizable on foreclosure." 484 U.S. at 369. But the Court's opinion does not even hint at any endorsement of a foreclosure value standard under the circumstances there (which in any event are quite different from the circumstances here). The bankruptcy judge in *Timbers* had valued the collateral for the purpose of determining how much the creditor should be compensated for being denied the opportunity to foreclose; the court thought it fair to award interest based on the estimated foreclosure proceeds. Currently, there is a split of authority among the lower courts about whether a foreclosure standard should be used for adequate protection purposes. *Compare, e.g., In re Demakes Enters., Inc.*, 145 B.R. 362 (Bankr. D. Mass. 1992) (liquidation value) *with General Elec. Credit Corp.* v. *QPL Components, Inc.* (*In re QPL Components, Inc.*), 20 B.R. 342, 346 (Bankr. E.D.N.Y. 1982) (retail fair market value); *see also* Chaim J. Fortgang & Thomas M. Mayer, *Valuation in Bankruptcy*, 32 U.C.L.A. L. Rev. 1061, 1069 & n.36 (1985) (citing split).

More broadly, the *Timbers* opinion was based on the balance struck in the Code between the rights of secured creditors and the needs of a reorganization. Although undersecured creditors were denied interest during the proceeding, they were entitled to relief from the stay if an effective reorganization was not in prospect within a reasonable time. *Id.* at 375-76. And this balance was struck in the context of the lower court's unchallenged statement that, if the reorganization were successful, the secured creditor would benefit by recovering the going concern value of the collateral. *United Sav. Ass'n* v. *Timbers of Inwood Forest Assocs.* (*In re Timbers of Inwood Forest Assocs.*), 808 F.2d 363, 373 (5th Cir. 1987) (*en banc*) ("The secured creditor benefits from a successful reorganization because its secured claim is *valued on a going-concern basis* in connection with a plan of reorganization, and the secured creditor is not compelled to liquidate its collateral at forced-sale prices") (emphasis added). How any of this supports respondents' advocacy of a liquidation valuation for property retained in a reorganization is mystifying.

C. The Practice Under Prior Bankruptcy Statutes Does Not Support Respondents' Interpretation of § 506(a)

Respondents and their *amici* contend that secured creditors should not be paid more than the disposition value of collateral because that is all they could recover under prior bankruptcy law. But, as shown below, Congress intended to rewrite the law in this area, not codify existing practices. Both of the statutory provisions at issue in this case are new. Indeed, under the Bankruptcy Act, a debtor in respondents' position who wanted to keep collateral would have to repay the full debt, and not just disposition value. In short, prior practice is not relevant, and in any event does not support respondents.

1. Congress clearly intended the Code to be a complete overhaul of the rules governing secured creditors in bankruptcy. "One of the *more significant changes from current law* in proposed title 11 is the treatment of secured creditors and secured claims." H.R. Rep. No. 95-595, at 180 (1977) (emphasis added), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6141. Congress found that under prior law, "secured creditors [were] dealt with erratically, tediously, and uncertainly, resulting from a hodgepodge of state and federal statutory provisions, bankruptcy and local rules, many conflicting reported cases and varied local customs." S. Rep. No. 95-989, at 13 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5799. This Court has previously recognized that the Code was intended to revamp the rules dealing with secured creditors, and thus found no basis for indulging in "a presumption of continuity with pre-Code practice." *United States* v. *Ron Pair Enters., Inc.*, 489 U.S. 235, 244-46 (1989).

2. The two statutory provisions at issue in this case certainly cannot be regarded as a continuation of pre-Code practice. Section 506(a) established a "*new* treatment of secured claims, especially the bifurcation of the claims into secured and unsecured claims." H.R. Rep. No. 95-595, at 181, 1978 U.S.C.C.A.N. at 6141 (emphasis added).[10] The cramdown power of § 1325(a)(5) is likewise new, as respondents and their *amici* admit; Chapter XIII of the Bankruptcy Act did not give debtors the power to modify their secured debts over the creditor's objection. On the contrary, chapter XIII "left secured creditors virtually unaffected" because "[e]ach secured creditor had to accept the plan before it could be confirmed." Resp. Br. 25; see 11 U.S.C. § 652(1) (1976 ed.; repealed).[11] Except for certain kinds of reorganizations, "no provision of the pre-Code statute permitted involuntary reduction of the amount of a creditor's lien for any reason other than payment on the debt. . . . Congress must have enacted the Code with a full understanding of this practice." *Dewsnup* v. *Timm*, 502 U.S. 410, 418-19 (1992).[12] And finally, to the limited extent that certain reorganizing companies could restructure their secured debts under the Bankruptcy Act, there was substantial authority for valuing the collateral on a going concern basis, including a scholarly decision issued just prior to the congressional consideration of the Code. *In re Pine Gate Assoc.*, 3 B.C.D. 301, 305-10 (Bankr. N.D. Ga. 1977) (Norton, J.). See generally Isaac M. Pachulski, *The Cram Down and Valuation Under Chapter 11 of the Bankruptcy Code*, 58 N.C. L. Rev. 925, 959-60 (1980). There was certainly no well-established pre-Code practice allowing debtors to retain collateral by paying liquidation value.

[10] The House Report noted "the uncertain treatment of secured creditors under current law," particularly when the creditor is *under*secured: "Current law is ambiguous and vague, especially under chapter XIII, on whether an undersecured creditor is to be treated as a secured creditor, or as a partially secured and partially unsecured creditor." H.R. Rep. No. 95-595, at 181, 1978 U.S.C.C.A.N. at 6141-42.

[11] It is true that a few courts asserted an "equitable" power to restructure secured debts in chapter XIII cases. *E.g.*, *Garcia* v. *General Motors Acceptance Corp.* (*In re Garcia*), 396 F. Supp. 518, 523 (C.D. Cal. 1974). But this was not the norm. *See* Resp. Br. 25; NACTT Br. 8.

[12] Most Bankruptcy Act reorganization cases were brought under chapter XI, which did *not* allow any restructuring of secured claims. *See SEC* v. *United States Realty & Improvement Co.*, 310 U.S. 434, 452 (1940). Although chapters X and XII authorized such restructurings, there was almost no case law discussing what valuation standard should be used—perhaps because in chapter X cases, which generally involved public companies, secured creditors were usually paid in full; otherwise, under the absolute priority rule, shareholders would receive nothing. The typical valuation in chapter X cases involved the determination of going concern value, as determined through a capitalization of earnings for the enterprise as a whole. *See Report of the Commission on the Bankruptcy Laws of the United States*, H.R. Doc. No. 93-137 (1973) ("*Commission Report*"), *reprinted in* L. King, *Collier on Bankruptcy* Vol. B, at App. Pt. 4-516 to 4-517 (15th ed. 1996).

3. The "bankruptcy rule" discussed by respondents' *amicus* (NACBA Br. 19-21) deals with the situation where the secured creditor recovers the collateral and, in addition, wants to receive the balance of its claim as an unsecured creditor. Under this rule, a lienholder "may avail himself of his security and share in the general assets as to the unsecured balance"; but the court first deducts the amount that the creditor received (or can be expected to receive) from disposition of the collateral. See *United States Nat'l Bank* v. *Chase Nat'l Bank*, 331 U.S. 28, 34 (1947). The same result obtains under § 506(a) of the Code when the debtor surrenders the collateral. But this rule sheds no light on how the court should value collateral which the debtor does not surrender and chooses to keep.

In sum, the Bankruptcy Code gives chapter 13 debtors a new statutory right—the right to keep collateral without paying the full debt it secures. To decide how much debtors should pay to exercise this new right, the Court should not look to the old law; it should look to the Code.

D. Neither the Legislative History Nor Subsequent Congressional Inaction Supports Respondents' Interpretation of the Statute

Although respondents and their *amici* cite bits of legislative history, those fragments cannot obscure one central fact. Respondents are urging this Court to adopt a single valuation standard for every case,[13] yet the legislative history, consistent with the rest of the statute, unambiguously rejects any single standard and states that, in some circumstances, courts should use the "full going concern value." See Pet. Br. 32 n.15, 39.[14]

[13] According to respondents, the only valuation standard permitted under § 506(a) is "the probable net proceeds to the secured creditor if the secured creditor had repossessed and sold its collateral." Resp. Br. 14; *see also* NACBA Br. 4 ("the expected net recovery on a hypothetical surrender of the property").

Respondents' *amici* also rely on congressional *inaction* to support their position. In 1983, the Senate passed a bill containing comprehensive revisions of the Bankruptcy Code, including a provision that would have specified a resale market value standard—a result that some lower courts had already reached. See, *e.g.*, *In re Reynolds*, 17 B.R. 489, 493 (Bankr. N.D. Ga. 1981). Other courts had applied liquidation value, and the Senate Judiciary Committee thought an amendment was necessary because "the original intent of the Congress in this regard has not been uniformly carried into practice by the courts." S. Rep. No. 98-65, at 5 (1983). Because this provision was not ultimately included in the 1984 amendments to the Bankruptcy Code, *amici* ask this Court to infer that Congress must have disapproved of this interpretation. But the failure of Congress to take sides on an issue dividing the bankruptcy bench cannot fairly be read as an endorsement of either position. For that reason, this Court has repeatedly refused to infer legislative intent from mere inaction, most recently in *California Division of Labor Standards Enforcement* v. *Dillingham Construction, N.A., Inc.*, 117 S. Ct. 832, 841 n.8 (1997) (failure of Congress to enact bills overruling lower court decisions given no weight). See also *Firestone Tire & Rubber Co.* v. *Bruch*, 489 U.S. 101, 114 (1989); *United States* v. *Price*, 361 U.S. 304, 313 (1960).

[14] The NACTT's reliance (Br. 9) on the recommendation of the *Commission Report* is misplaced, because Congress rejected the Commission's proposal. See Pet. Br. 39 & n.19, which notes the Senate Judiciary Committee's inclusion of the second sentence of § 506(a) to make it clear that value depends on the proposed disposition or use.

E. The Fair Market Value Standard, Unlike the Foreclosure Value Standard, Accords With Customary Appraisal Standards

Respondents contend at length that this Court should not adopt a fair market value standard based on what the debtor would have to pay to obtain comparable property because it "radically departs from traditional appraisal theory" and would require "fundamental alterations in appraisal methodology." Resp. Br. 26, 20. Nothing could be further from the truth. Petitioner is simply asking this Court to apply "the traditional common-law notion of fair market value." *BFP* v. *Resolution Trust Corp.*, 511 U.S. 531, 548 (1994). In *BFP*, this Court quoted with approval the following definition:

> "The market value of . . . a piece of property is the price which it might be expected to bring if offered for sale in a fair market; not the price which might be obtained on a sale at public auction or a sale forced by the necessities of the owner, but such a price as would be fixed by negotiation and mutual agreement, after ample time to find a purchaser, as between a vendor who is willing (but not compelled) to sell and a purchaser who desires to buy but is not compelled to take the particular . . . piece of property."

Id. at 537-38 (quoting *Black's Law Dictionary* 971 (6th ed. 1990)).

This formulation of the fair market value standard is virtually identical to the one advocated by respondents. See Resp. Br. 27. It is the very standard that appraisers customarily use, and indeed they are required to use such a standard when valuing real estate collateral in federally regulated transactions. See 12 C.F.R. § 34.42(g). The fair market value standard is well understood by courts and appraisers alike. The "foreclosure value" standard, by contrast, would require appraisers to depart from their normal practice. As this Court noted, "[a]n

appraiser's reconstruction of 'fair market value' could show what similar property would be worth if it did not have to be sold within the time and manner strictures of state-prescribed foreclosure." *BFP*, 511 U.S. at 539. However, "market value, as it is commonly understood, has no applicability in the forced-sale context; indeed, it is the very *antithesis* of forced-sale value." *Id.* at 537 (emphasis in original).

Appraisers can use several approaches to determine fair market value. For motor vehicles, homes and other types of readily marketable property, appraisers commonly employ the *comparable sales* method—they look at the prices paid for similar properties. That is the approach used by *both* expert witnesses in this case, each of whom consulted industry publications to determine the prices paid for 1989 Kenworth T600A tractors. For other types of property, appraisers may use the *capitalized income* approach or the *replacement cost* approach.[16] All of these techniques can be used where appropriate to determine fair market value.

Respondents contend that trucks should not be valued using published retail figures because the "reported values are universally recognized as unreliable." Resp. Br. 26-27. But no evidence or literature is cited in support of this assertion. In fact, respondents' own expert witness relied on the published *retail* value to arrive at his estimate of wholesale value: "I took the figures from the truck blue book to establish the retail price, [then] backed off 25 percent for wholesale price." Jt. App. 79. In any event, the reliability of a particular published value is an evidentiary matter that this Court need not address; some ex-

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[16] Respondents are correct in pointing out that the term "replacement cost" is used in different ways. The panel opinion below used that phrase to refer to the cost of purchasing a comparable used truck. Pet. App. 104a-105a. To an appraiser, this is the *sales comparison* approach. Appraisal Institute, *The Appraisal of Real Estate* 71, 367 (10th ed. 1992). The replacement cost approach involves determining the cost of building or purchasing a brand new replacement with utility equivalent to the item being appraised, and then deducting depreciation. *Id.* at 318, 319.

perts may not rely on the blue book, and others may conclude that adjustments are necessary.[16]

The legal question here is *which* market is the relevant one—the market in which the debtor would buy such collateral if he chose to *use* it or the one in which the creditor would *dispose* of it. Once the relevant market is defined, the bankruptcy courts, as triers of fact, will decide the best way of ascertaining market value on the basis of the evidence presented. For the reasons explained earlier, the selection of the relevant market turns on the "proposed disposition or use of such property," as set forth in § 506(a). In this case, respondents propose to use the truck, so the relevant measure of value is what it would cost them to purchase a comparable vehicle.

CONCLUSION

For the foregoing reasons and those stated in petitioner's opening brief, the judgment of the court of appeals should be reversed.

Respectfully submitted,

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April 9, 1997

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[16] Petitioner agrees with respondents that published values "should not be the exclusive reference point" (Resp. Br. 37), and that adjustments may be appropriate to reflect the condition of the vehicle (*e.g.*, mileage, damage, accessories). In this case, respondent testified that his truck was in "average good condition" (Jt. App. 66), and neither expert saw any reason to make any adjustment because of the condition of the vehicle. Jt. App. 69, 79-80.

9

No. 96-454

In the Supreme Court of the United States

OCTOBER TERM, 1996

ASSOCIATES COMMERCIAL CORPORATION, PETITIONER

v.

ELRAY AND JEAN RASH

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

BRIEF FOR THE
UNITED STATES AS AMICUS CURIAE
SUPPORTING PETITIONER

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QUESTION PRESENTED

Whether, when a debtor in a bankruptcy case is permitted to retain property that secures the claim of a secured creditor, the allowed amount of the secured claim is to be valued under Section 506(a) of the Bankruptcy Code at (i) the amount the creditor would realize from a hypothetical foreclosure sale of the property or (ii) the fair market value of the property in the hands of the debtor.

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In the Supreme Court of the United States

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BRIEF FOR THE
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SUPPORTING PETITIONER

INTEREST OF THE UNITED STATES

This case concerns whether, when a debtor is permitted to retain property that secures the claim of a secured creditor, the allowed amount of the secured claim is limited, under Section 506(a) of the Bankruptcy Code, to the amount that the creditor would have obtained in a hypothetical foreclosure sale. This issue is of substantial importance to the United States. The United States often becomes a secured creditor under federal programs involving loans, loan guarantees, contracts and tax collection activities. The rights of the United States as a secured creditor

are frequently affected by valuations of collateral under Section 506(a).

Because the decision in this case conflicts directly with decisions of the First, Second, Fourth, Sixth, Seventh, Eighth and Ninth Circuits, the United States and its agencies face disparate treatment in different circuits of identical claims arising under national programs. The United States therefore has a substantial interest in the resolution of this continuing conflict.

STATUTORY PROVISIONS INVOLVED

1. Section 506(a) of the Bankruptcy Code, 11 U.S.C. 506(a), provides:

> An allowed claim of a creditor secured by a lien on property in which the estate has an interest, or that is subject to setoff under section 553 of this title, is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property, or to the extent of the amount subject to setoff, as the case may be, and is an unsecured claim to the extent that the value of such creditor's interest or the amount so subject to setoff is less than the amount of such allowed claim. Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor's interest.

2. Section 1325 of the Bankruptcy Code, 11 U.S.C. 1325, provides in relevant part:

> (a) Except as provided in subsection (b), the court shall confirm a plan if—

* * * * *

> (5) with respect to each allowed secured claim provided for by the plan—
>
> (A) the holder of such claim has accepted the plan;
>
> (B)(i) the plan provides that the holder of such claim retain the lien securing such claim; and
>
> (ii) the value, as of the effective date of the plan, of property to be distributed under the plan on account of such claim is not less than the allowed amount of such claim; or
>
> (C) the debtor surrenders the property securing such claim to such holder * * *.

STATEMENT

1. In 1992, respondents Elray and Jean Rash filed for relief under Chapter 13 of the Bankruptcy Code (Pet. App. 110a). Petitioner Associates Financial Commercial Corporation had provided purchase money financing to respondents and held a lien on a truck that respondent Elray Rash used in his business (*id.* at 111a). Over petitioner's objection, respondents proposed a plan under which (i) respondents would retain the truck for use in the continued operation of the business and (ii) the amount of petitioner's allowed secured claim would be reduced to the wholesale value of the truck (*id.* at 2a, 111a).[1]

[1] The plan proposed by respondents is what is known as a "cramdown" plan, which is a plan that the debtor seeks to have confirmed over the objection of a secured creditor. When a

The bankruptcy court approved the plan and also approved respondents' valuation of petitioner's allowed secured claim. The court found that the truck had a wholesale value of $31,875 and a retail value of $42,500 (Pet. App. 111a). The court concluded that, under Section 506(a) of the Bankruptcy Code, the "allowed secured claim" should be valued at the wholesale value of the truck because "wholesale value most often equates to the value in the hands of the creditor after he has deducted his foreclosure and disposition costs so that it is a reasonable indication of the net proceeds he will receive upon the disposition of the reclaimed collateral" (*id.* at 113a). The district court affirmed the bankruptcy court's orders (*id.* at 83a-88a).

2. a. A panel of the court of appeals reversed (Pet. App. 100a-109a). The panel held that, under Section 506(a) of the Bankruptcy Code, the value of the allowed secured claim was the retail or replacement value of the truck in the hands of the debtor, not the wholesale value of the truck (Pet. App. 109a).

b. Respondent filed a petition for rehearing en banc. While that petition was pending, the First, Eighth, and Ninth Circuits issued decisions that agreed with the reasoning and conclusion of the panel

debtor proposes a "cramdown" plan under which it will retain collateral that secures the claim of a secured creditor, the plan can be confirmed only if it provides payments to the secured creditor that equal or exceed the present value of the "allowed secured claim." 11 U.S.C. 1325(a)(5). The amount of the "allowed secured claim" is determined under Section 506(a) of the Bankruptcy Code, 11 U.S.C. 506(a). The portion of the secured claim that is not treated as an "allowed secured claim" under Section 506(a) is to be treated as an unsecured claim. *Ibid.*

decision in this case and with earlier decisions of the Sixth and Fourth Circuits on this same issue. *In re Winthrop Old Farm Nurseries, Inc.*, 50 F.3d 72 (1st Cir. 1995); *In re Trimble*, 50 F.3d 530 (8th Cir. 1995); *In re Taffi*, 68 F.3d 306 (1995), aff'd in part on reh'g en banc, 96 F.3d 1190 (9th Cir. 1996), petition for cert. pending, No. 96-881; *In re McClurkin*, 31 F.3d 401 (6th Cir. 1994); *In re Balbus*, 933 F.2d 246 (4th Cir. 1991); *In re Coker*, 973 F.2d 258 (4th Cir. 1992).

In an en banc decision in which nine judges joined and six judges dissented, however, the Fifth Circuit rejected the panel decision and held that the value of the allowed secured claim must be limited to the wholesale value of the truck—the theoretical amount that the creditor would realize at a hypothetical foreclosure sale (Pet. App. 14a, 51a).

c. After the Fifth Circuit issued its *en banc* decision in this case, the Ninth Circuit issued an *en banc* opinion in *In re Taffi, supra*, expressly disagreeing with the Fifth Circuit and holding that, when the collateral is retained by the debtor, Section 506(a) requires that the secured claim be valued at the replacement, or fair market, value of the collateral. The Second and Seventh Circuits thereafter issued opinions in which they disagreed with all of the previous appellate decisions and concluded that, when the collateral is retained by the debtor, the "allowed secured claim" may be valued at the average of the wholesale and retail replacement values. *In re Valenti*, No. 95-5079, 1997 WL 31577 (2d Cir. Jan. 15, 1997); *In re Hoskins*, 102 F.3d 311 (7th Cir. 1996).

SUMMARY OF ARGUMENT

1. The claim of a creditor who possesses a lien on any property of a bankruptcy estate is a "secured claim" under the Bankruptcy Code only "to the extent of the value of such creditor's interest in the estate's interest in such property" (11 U.S.C. 506(a)). The statute specifies that "[s]uch value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property" (*ibid.*).

When, as in this case, "the proposed disposition or use" of the collateral to which the lien has attached is that it will be retained for the use of the debtor, the "value" of that property (and thus the amount of the "secured claim" under the statute) is the price that a willing buyer in the debtor's position would pay to obtain such property from a willing seller. Because, in this case, the debtor is a retail buyer of such property, the "value" of such property in the debtor's hands is the retail or replacement cost of such property to the debtor. That valuation of the property reflects the "economic benefit for the debtor" from its continued possession and "use of the collateral to generate an income stream" (*In re Winthrop Old Farm Nurseries, Inc.*, 50 F.3d 72, 75 (1st Cir. 1995)).

2. The court of appeals erred in this case in concluding that the "value" of the collateral (and therefore the amount of the "secured claim") equals the net proceeds that the creditor would have obtained if the property had been sold at a foreclosure sale. As all other appellate courts have concluded, if the "value" of the collateral is limited to the amount realizable from a hypothetical foreclosure sale even when a foreclosure is *not* to be conducted because the

collateral is instead to be retained and used by the debtor, "then the last sentence of the statute which provides that the value should be determined in light of the purpose of the valuation and the proposed disposition or use of the property would be surplusage" (*In re Trimble*, 50 F.3d 530, 532 (8th Cir. 1995)).

As these courts have explained, "[W]hen a debtor intends to continue use of creditor's collateral, the Debtors are acknowledging the value of the collateral to be greater than if liquidated" (*In re Trimble*, 50 F.3d at 531). The "debtor should not be heard to argue that, in valuing the collateral, the court should disregard the very event that, according to the debtor's plan, *will* take place—namely, the debtor's use of the collateral to generate an income stream." *In re Winthrop Old Farm Nurseries, Inc.*, 50 F.3d at 75. When property is to be retained by the debtor, its value in the hands of the debtor is thus "equal to [its] fair market value," not to its foreclosure value (*ibid.*).

3. In two recent decisions, the Second and Seventh Circuits have concluded that the value of collateral that will be retained and used by the debtor (and therefore the amount of the "secured claim" under Section 506(a)) is an amount halfway between (i) the retail price that a willing buyer in the debtor's position would actually be required to pay to obtain such property and (ii) the wholesale price for such property (even though that price would not be available to a buyer in the debtor's position). That "compromise" method for valuing collateral retained by the debtor lacks support either in logic or in the text of the statute.

Commercial property retained by the debtor has a readily discernible "value." That value is the cost that the debtor would incur in obtaining similar

property for the same use—the price that a willing buyer in the debtor's position would pay a willing seller for the right to obtain and use such property. The debtor in this case would be required to purchase such property at retail and would not be able to purchase such property at wholesale. The "value" of the property in the debtor's hands is thus necessarily its retail price—for that is the price the debtor would be required to pay for the right to use such property in its business.

ARGUMENT

WHEN THE DEBTOR IS PERMITTED TO RETAIN FOR HIS OWN USE THE COLLATERAL THAT SECURES A CREDITOR'S CLAIM, THE AMOUNT OF THE "ALLOWED SECURED CLAIM" IS THE FAIR MARKET VALUE, OR REPLACEMENT COST, OF THE PROPERTY IN THE HANDS OF THE DEBTOR

This case involves the proper valuation of a secured claim in a bankruptcy case when the debtor is permitted to retain and use the property that secures the claim. When, as in the present case, the debtor proposes to retain such property under a plan to which the secured creditor has objected, the court may approve the plan only if, among other requirements, it ensures that the holder of the secured claim will receive no less than the present value of the "allowed amount" of the "allowed secured claim." 11 U.S.C. 1325(a)(5)(B). See also 11 U.S.C. 1129(b)(2)(A)(i).

The "allowed amount of such claim" is determined under Section 506(a) of the Bankruptcy Code, 11 U.S.C. 506(a). The first sentence of Section 506(a) provides that an "allowed claim" that is secured by

property of the estate is "a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property" and is an unsecured claim to the extent the claim exceeds that value. *Ibid.* The second sentence of Section 506(a) specifies that "[s]uch value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property" (*ibid.*). The question in this case is how this "value" is to be determined when the "proposed disposition or use" of the property is that it will be retained by the debtor rather than sold at a foreclosure sale.

The court of appeals concluded in this case that, whether the property is to be sold at foreclosure or is instead to be retained for the use of the debtor, the "value" of the property in either situation is the same—the hypothetical net proceeds that would be realized *if* the property were sold at foreclosure. The court concluded that this hypothetical net foreclosure value is equal to the "wholesale" price of the property (Pet. App. 14a, 51a). As eight other courts of appeals have concluded, however, the analysis of Section 506(a) adopted by the court in this case is in error.

1. Under Section 506(a) of the Bankruptcy Code, the amount of the secured claim is defined by statute as the "value" of the "creditor's interest in the estate's interest" in the property. 11 U.S.C. 506(a). The court of appeals concluded that this sentence necessarily refers to the value that the creditor would receive if it foreclosed on the collateral—on the theory that the right of foreclosure represents the "creditor's interest" in the property (Pet. App. 14a). As all other courts of appeals have concluded, however, the "value" of the "creditor's interest" in the property is not limited to net foreclosure proceeds

when, as in the present case, the property is to be retained by the debtor and is *not* to be sold at foreclosure.

a. First, it is fundamentally incorrect to say that a creditor's interest in the property is to receive "only the net proceeds from the disposition of the collateral." *In re McClurkin*, 31 F.3d 401, 404 (6th Cir. 1994). "When a creditor forecloses * * * , the creditor 'receives' *all* of the proceeds of the sale." *Ibid.* When no costs are incurred in such a sale (as when a private sale is arranged), no reduction in the proceeds of the sale occurs. Section 506(a) "does not require or permit a reduction in the creditor's secured claim to account for purely hypothetical costs of sale" when such costs are, in fact, *not* incurred because the debtor has been permitted to *retain* the property and foreclosure has been enjoined by the bankruptcy court. *Id.* at 405. Accord, *e.g.*, *In re Taffi*, 96 F.3d at 1192 ("Hypothetical sale costs are not to be considered because no sale is intended."); *In re Winthrop Old Farm Nurseries, Inc.*, 50 F.3d at 74 ("no deduction for hypothetical costs of sale" that are not, in fact, incurred).

Furthermore, as the court explained in *In re Green*, 151 B.R. 501, 505 (Bankr. D. Minn. 1993):

> the fact that a lien in property gives the lienholder a right to repossess and sell the collateral does not automatically mean that the value of the lien is equal to the amount that the creditor would receive upon disposition of the collateral in satisfaction of its lien. It must be remembered that a lien is fundamentally a *security* interest which secures payment of an obligation. To value such an interest in property based solely on the amount that could be realized upon sale of the collateral ignores the value associated with the right to receive the stream of payments that the lien secures.

The "value of the creditor's lien is derived from the stream of payments that the lien secures, rather than the right to foreclose," especially when, as in this case, "no liquidation of the collateral is contemplated" under the debtor's plan. *Id.* at 504.

b. Second, the text of the statute expressly requires that, in determining "value," consideration is to be given to the "purpose of the valuation" and to the "proposed disposition or use of such property" (11 U.S.C. 506(a)).[2] "[B]ecause the reorganizing debtor proposes to retain and use the collateral, it should *not* be valued as if it were being liquidated." *In re Winthrop Old Farm Nurseries, Inc.*, 50 F.3d at 74. Instead, "courts should value the collateral 'in light of' the debtor's proposal to retain it and ascribe to it its going-concern or fair market value with no deduction for hypothetical costs of sale." *Ibid.*

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[2] "[T]he purpose of the valuation" refers to the procedural context in which the bankruptcy court is called upon to make a valuation. For example, this context may be the confirmation of a plan, the determination whether a secured creditor is adequately protected or the determination whether the debtor has exceeded the maximum amount of unsecured debts permitted for a Chapter 13 case. See, *e.g.*, *In re Balbus*, 933 F.2d 246 (4th Cir. 1991); David G. Carlson, *Secured Creditors and the Eely Character of Bankruptcy Valuations*, 41 Am. U.L. Rev. 63, 65-70 (1991). The "disposition" of the property may include the sale of property at foreclosure or its retention by the debtor. The "use" of the property may include the production of income (by its use or rental), personal use by the debtor or any other use approved by the bankruptcy court.

As several courts have emphasized in rejecting a foreclosure valuation for collateral that is to be retained by the debtor and *not* sold at foreclosure (*In re Trimble*, 50 F.3d at 532):

> If the first sentence of § 506(a) were interpreted to mean that the value must be fixed at the amount which the creditor would receive on foreclosure, then the last sentence of the statute which provides that the value should be determined in light of the purpose of the valuation and of the proposed disposition or use of the property, would be surplusage.

Accord, *e.g.*, *In re Winthrop Old Farm Nurseries, Inc.*, 50 F.3d at 76 (the use of foreclosure value when no foreclosure is intended "renders the second sentence of § 506(a) virtually meaningless"); *In re Balbus*, 933 at 250-251. "[T]he only way to read the statute without effectively erasing the second sentence [is] to deduct sales costs only if there were an actual sale." *Lomas Mortgage USA* v. *Wiese*, 980 F.2d 1279, 1285 (9th Cir. 1992), vacated on other grounds, 508 U.S. 958 (1993). As the court explained in *In re Courtright*, 57 B.R. 495, 497 (Bankr. D. Ore. 1986) (emphasis added), the contrary interpretation of the statute adopted by the court of appeals in this case

> would mean that the value should always be fixed at the amount which the creditor would receive upon foreclosure regardless of the purpose of the valuation and of the proposed disposition or use of the property. The test would not depend upon whether the debtor intended to release the property or intended, instead to retain and use the property. *It is not appropriate for the court to ignore or give no effect to the language of the last sentence of the statute.*

Accord, *e.g.*, *In re Coker*, 973 F.2d 258, 260 (4th Cir. 1992) ("all provisions in a statute must be given effect").

A proposal under the plan to retain, rather than sell, the collateral is quite obviously a proposal about the "disposition or use" of that collateral. Congress expressly required that the "proposed disposition or use" be considered in valuing the secured claim. A rule of law that makes sale or retention irrelevant—and that mandates the same valuation in either event—would make the second sentence of Section 506(a) surplusage and is, for that reason, unacceptable.[3] See *Bailey* v. *United States*, 116 S.Ct. 501, 506-507 (1995); *United States* v. *Nordic Village, Inc.*, 503 U.S. 30, 36

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[3] The court of appeals stated that its valuation standard does not establish a fixed rule for all cases because "what the creditor could realize at a foreclosure sale is only a *starting point* for the valuation" and the "bankruptcy court may make additions to or deductions from this amount depending upon 'equitable considerations arising from the facts of the case'" (Pet. App. 48a). The statute, however, requires that the valuation be made based upon the "proposed disposition or use" of the collateral, not based upon "equitable factors." Compare 11 U.S.C. 506(a) with 11 U.S.C. 552(b) (instructing bankruptcy court to consider the "equities of the case" in determining post-petition effect of security interest). Moreover, as the dissent noted in this case, if "equitable considerations" properly enter into the valuation of secured claims, they can be applied to valuations made from any "starting point" – whether that point is retail or foreclosure value (Pet. App. 74a). The use of foreclosure value for the valuation of collateral that is not to be sold at foreclosure simply ignores the statutory requirement that the "proposed disposition or use" of the collateral be considered in every valuation under Section 506(a).

(1992); *Reiter* v. *Sonotone Corp.* 442 U.S. 330, 339 (1979).

c. When property is to be retained by the debtor rather than sold at foreclosure, valuing the property at its replacement cost corresponds to the economic reality of its "proposed disposition or use" and "is the only method that gives full effect to the entire language of section 506(a)." *In re Trimble*, 50 F.3d at 532. When the replacement cost to the debtor is the retail price—because the debtor is a retail rather than a wholesale buyer—the "retail valuation" properly reflects the "economic benefit for the debtor" from its continued possession and "use of the collateral to generate an income stream" (*In re Winthrop Old Farm Nurseries, Inc.*, 50 F.3d at 75).

A debtor who seeks "to continue use of [the] creditor's collateral" thereby "acknowledg[es] the value of the collateral to be greater than if liquidated." *In re Trimble*, 50 F.3d at 531. The "debtor should not be heard to argue that, in valuing the collateral, the court should disregard the very event that, according to the debtor's plan, *will* take place—namely, the debtor's use of the collateral to generate an income stream." *In re Winthrop Old Farm Nurseries, Inc.*, 50 F.3d at 75. When property is thus to be retained by the debtor, its value in the hands of the debtor is therefore "equal to [its] fair market value," or replacement cost, rather than merely its net foreclosure value. *Ibid.* Accord, *e.g.*, *In re Trimble*, 50 F.3d at 532 ("the retail value * * * without deduction for costs of repossession or sale"); *In re McClurkin*, 31 F.3d at 404-405. See also *In re Taffi*, 96 F.3d at 1192 ("the price which a willing seller under no compulsion to sell and a willing buyer under no compulsion to buy would agree upon").

d. As the court explained in *In re Taffi*, 96 F.3d at 1192-1193, "[t]here is nothing inequitable" in valuing collateral retained by the debtor at its fair market price for, by "allowing the [debtors] to retain [the collateral,] the [creditor] runs a risk" that ultimate recovery will be deferred or defeated. When a creditor is permitted to sell property at foreclosure, the net foreclosure proceeds are then promptly received. When, by contrast, the "proposed disposition" is for the debtor to retain the property, the creditor receives payment of its secured claim only in small portions over time. As the court stated in *In re Balbus*, 933 F.2d at 250, quoting *In re Crockett*, 3 B.R. 365, 367 (Bankr. N.D. Ill. 1980):

> [T]he debtors cannot eat with the hounds and run with the hares. Seeking retention of the property, they cannot insist on liquidation values to be paid to the creditor in installments.

Valuing the collateral retained by the debtor at its fair market or replacement cost does not effect any "'windfall' to the creditor, and certainly not one that will spur secured creditors to eschew their state law remedies and seek refuge in the comfortable confines of the bankruptcy courts." *In re Winthrop Old Farm Nurseries, Inc.*, 50 F.3d at 76.[4] By contrast, the

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[4] This Court has established the general principle that a party should not receive "a windfall merely by reason of the happenstance of bankruptcy." *Butner* v. *United States*, 440 U.S. 48, 55 (1979), quoting *Lewis* v. *Manufacturers National Bank*, 364 U.S. 603, 609 (1961). A secured creditor does not enjoy a "windfall" by the proper valuation of collateral retained by the debtor. A "windfall" is a benefit received without risk or cost. The secured creditor in a cramdown has

decision of the court of appeals in this case would create a situation prone to abuse—if the debtor were permitted to retain the collateral and to "strip[] down the lien to liquidation value," the debtor could then "sell[] the collateral at fair market value, thus pocketing equity that would have been completely beyond reach save for the filing of the bankruptcy petition." *Ibid.*

2. a. The court of appeals failed to justify its departure from the statutory requirement that the "proposed disposition or use" of the collateral be considered in valuing the secured claim. The court reasoned that the "proposed disposition or use" of the collateral would remain relevant in determining the net foreclosure value by "delineating the market for the collateral by indicating a use which may be of interest to potential buyers at a foreclosure sale" (Pet. App. 25a). But the proposed *future* use of the property by the debtor is of no relevance in establishing the net proceeds from a hypothetical foreclosure sale that would be conducted *before* the property is put to that use. If, by hypothesis, the property were sold at foreclosure, the particular use thereafter made of that property by the hypothetical buyer might increase or decrease the *subsequent* value of the property. But that future use would not alter the value of the property on the date of the approval of the plan—which is the relevant date for valuation of the "secured claim" under Section 506(a). 4 *Collier on Bankruptcy* ¶ 506.02[6][j], at 506-31 (15th ed. rev. 1996).

incurred both risks and costs from the deferral and resulting diminution of recovery upon its secured claim.

For the same reason, the court erred in stating that a "proposed disposition or use" of the property would remain relevant if that use were "particularly beneficial, or particularly detrimental, to [the] value" of the collateral (Pet. App. 25a, quoting James F. Queenan, Jr., *Standards for Valuation of Security Interests in Chapter 11*, 92 Com. L.J. 18, 37 (1987)). A *subsequent* use that benefits or depreciates the collateral has no bearing on the value of that collateral *before* that use is authorized by the bankruptcy plan. It therefore has no bearing on value when the "purpose of the valuation" (11 U.S.C. 506(a)) is to determine the value of collateral on the date that the plan is approved.[5]

[5] When, by contrast, only a *temporary* use of the property by the debtor is intended before foreclosure is to be allowed, a detrimental use may decrease the foreclosure value of the collateral. Congress specified in Sections 361 and 363 of the Bankruptcy Code that the debtor must provide additional, "adequate protection" to the creditor's interest if temporary use of the collateral by the debtor would "result[] in a decrease in value" of the creditor's interest. 11 U.S.C. 361(1). See 11 U.S.C. 363(e). When the "purpose of the valuation" (11 U.S.C. 506(a)) is to determine a need for adequate protection, Congress thus specified in Section 361(1) that the effect of the temporary use on the value of the collateral must be considered.

The need for "adequate protection" arising from temporary use of the collateral by the debtor is one of the many contexts in which a valuation of the collateral is required under Section 506(a). See note 2, *supra*. The requirement in Section 506(a) that the "proposed disposition or use" of collateral be considered does not, as the court of appeals mistakenly suggested (Pet. App. 26a-27a), refer only to valuations for the purpose of determining "adequate protection" under Section 361. There was no reason for Congress to specify in the general valuation provisions of Section 506(a) that the

b. The court of appeals also erred in reasoning that deference to state law requires that the value of the "secured claim" under Section 506(a) be limited to the net foreclosure value of the property. The court stated that, outside of the bankruptcy context, state law would permit the secured creditor to sell the collateral and thereby obtain its net foreclosure value "and nothing more" (Pet. App. 14a). The court concluded that, in enacting the Bankruptcy Code, Congress would not have altered that nonbankruptcy, state-law right of secured creditors without saying so in the clearest of terms (*id.* at 9a-10a).

But Congress obviously *has*, in the clearest of terms, authorized substantial departures from state law in reshaping creditor rights under the Bankruptcy Code. Of particular relevance to this case, Congress has (i) enjoined the secured creditor from exercising its right to foreclose on the collateral during the pendency of the bankruptcy case (11 U.S.C. 362) and (ii) authorized the bankruptcy court to permit the debtor thereafter to retain and use the collateral (11 U.S.C. 1129(b)(2)(A)(ii), 1325(a)(5)(B)). It is precisely because federal law thus disrupted the state-law rights of creditors in bankruptcy cases that it was necessary for Congress, in Section 506(a) of the Bankruptcy Code, to require that the ultimate "disposition or use" of the collateral be given account in determining the value of the "secured claim."

"proposed disposition or use" of collateral be considered if all that Congress meant to require was that a "detrimental" use be considered when the temporary possession of the collateral by the debtor would "result[] in a decrease in the value" of the creditor's interest. 11 U.S.C. 361(1). The plain text of Section 361(1) had already made that requirement clear.

When a debtor is permitted by the Bankruptcy Code to retain and use the collateral, the state-law right of the secured creditor to obtain immediate foreclosure is displaced as a matter of federal law. Section 506(a) then reconstitutes the rights of the secured creditor, as a matter of federal law, based upon the "proposed disposition or use" of the collateral. For this reason, all of the courts of appeals (other than the court in this case) have agreed that prebankruptcy state-law rights do not govern the determination of post-bankruptcy creditor rights under Section 506(a). See, *e.g.*, *In re Taffi*, 96 F.3d at 1192; *In re Trimble*, 50 F.3d at 531; *In re Winthrop Old Farm Nurseries, Inc.*, 50 F.3d at 75; *In re McClurkin*, 31 F.3d at 404-405. As the dissent noted in this case (Pet. App. 69a), valuing the secured claim at the replacement cost of the property in the hands of the debtor

> would not "displace" a well-established area of state law, for the simple reason that there is no state law regarding the rights of secured creditors in reorganizations. In fact, the Constitution has prevented the states from passing such laws for the past 207 years.

It is federal law, not state law, that determines the rights of secured creditors in bankruptcy.

c. The court of appeals also erred in relying on legislative history to nullify the statutory text. Legislative history cannot annul the plain command of the statute that the "proposed disposition or use" of the collateral be considered in valuing the secured claim (11 U.S.C. 506(a)). Moreover, to the extent that such history is relevant, it confirms that the court of appeals erred in interpreting the statute to require a

net foreclosure valuation when property is retained by the debtor and foreclosure is *not* permitted.

The Senate Report confirms that any valuation of the secured claim must reflect the proposed disposition or use of the collateral: "While courts will have to determine value on a case-by-case basis, [Section 506(a)] makes it clear that valuation is to be determined in light of the purpose of the valuation and the proposed disposition or use of the subject property." S. Rep. No. 989, 95th Cong., 2d Sess. 68 (1978). The House Report similarly rejects any rule that would impose a forced sale or liquidation value in all cases:

> "Value" does not necessarily contemplate forced sale or liquidation value of the collateral; nor does it always imply a full going concern value. Courts will have to determine value on a case-by-case basis, taking into account the facts of each case and the competing interests in the case.

H.R. Rep. No. 595, 95th Cong., 1st Sess. 356 (1977). Imposing a "forced sale or liquidation value" in *every* case—as the court of appeals would require—fails to honor both the statutory text and the evident legislative intent that the "proposed disposition or use" of the property be considered in valuing the secured claim.

The court of appeals sought to rely on passages from the House Report that suggest that a Chapter 13 debtor would, in narrowly defined situations, be able to retain certain types of property without paying "high replacement costs" (Pet. App. 42a, quoting H.R. Rep. No. 595, *supra*, at 127). The portion of the House Report on which the court relied, however, concerns a different statutory provision and a

different substantive issue than is involved in this case. Section 722 of the Bankruptcy Code established a "new and * * * broader" right of redemption for debtors than existed under preexisting state law. S. Rep. No. 989, *supra*, at 95. Under Section 722, a debtor may "redeem tangible personal property intended primarily for personal, family, or household use" when such property is not within the bankruptcy estate and is therefore subject to prompt foreclosure under state law. 11 U.S.C. 722. To avoid foreclosure and the attendant necessity (in the absence of a state-law right of redemption) of purchasing a similar item at a "high replacement cost" (H.R. Rep. No. 595, *supra*, at 127), the debtor is permitted by Section 722 to extinguish the lien by "redeeming" it in advance of foreclosure. The House Report explains, as an example, that, if the personal property to which the statute applies is "subject to a $1200 lien," "[t]his section permits [the debtor] to pay the holder of the lien $1200 and redeem the entire [property]." *Id.* at 381.

This right of redemption under Section 722 applies when the creditor would be permitted to receive an immediate payment of its lien through foreclosure. H.R. Rep. No. 595, *supra*, at 127. Section 722 does not apply to the different situation addressed in this case, when (i) property is to be retained and used by the debtor, (ii) foreclosure of the lien is not permitted, and (iii) prompt payment of the creditor will not occur. The history of Section 722 thus provides no guidance for the proper valuation of the secured claim in the markedly different context of this case.

Indeed, the House version of the bill—on which the House Report was based—provided no guidance whatever concerning the proper method for valuing a secured claim. See H.R. 8200, 95th Cong., 1st Sess.,

§ 506(a) (1977). The requirement of Section 506(a) that the "proposed disposition or use" of the collateral be considered in such valuations originated in the competing Senate version of the bill (S. 2266, 95th Cong., 1st Sess., § 506(a) (1977) (amended May 17, 1978)) and was adopted in conference in preference to the House bill. 124 Cong. Rec. 32,398 (1978) (Rep. Edwards); 124 Cong. Rec. 33,997 (1978) (Sen. DeConcini). The provisions of Section 506(a) that are at issue in this case were not reflected in the House Report on which the court of appeals relied.

d. Finally, the court of appeals erred in stating (Pet. App. 29a) that "Economic Analysis" supports nullification of the statutory command that the "proposed disposition or use" of the collateral be considered in valuing the secured claim. The court reasoned that foreclosure valuation of the collateral is preferable because it denies the secured creditor the benefit of retail sales expenses "in which the creditor does not have a security interest" (*id.* at 32a). The court stated that any valuation above net foreclosure value would improperly give the secured creditor a "windfall * * * in the form of a 'cram down premium'" (*id.* at 34a-37a).

It is, however, plainly the task of Congress, not the courts, to determine the ultimate fairness or wisdom of the statutory rules that allocate the limited funds and property of the debtor among competing claimants in bankruptcy cases. The possibility that a court might prefer a balance of interests that differs from the balance struck by Congress does not jusify a departure from the statutory text. "We are bound by the language of the statute as it is written, and even if the rule [a party] advocates might 'accor[d] with good policy,' we are not at liberty 'to rewrite [the] statute

because [we] might deem its effects susceptible of improvement.'" *Commissioner* v. *Lundy*, 116 S.Ct. 647, 656-657 (1996), quoting *Badaracco* v. *Commissioner*, 464 U.S. 386, 398 (1984).

Moreover, for the reasons discussed above, "[t]here is nothing inequitable" in valuing collateral retained by the debtor at its fair market price (*In re Taffi*, 96 F.3d at 1192). Indeed, if the debtor were permitted to *avoid* foreclosure by retaining the collateral *and* the secured claim were stripped down to its foreclosure value under Section 506(a), an evident potential for abuse would exist from the debtor's ability then to "pocket[] equity that would have been completely beyond reach save for the filing of the bankruptcy petition." *In re Winthrop Old Farm Nurseries, Inc.*, 50 F.3d at 76. See pages 15-16 & note 4, *supra*.

3. a. Eight circuits have rejected the conclusion of the court of appeals in this case that, when the debtor is to retain the collateral, the secured claim is to be reduced to its net foreclosure valuation. Six of these circuits have agreed that, in this context, the value of the secured claim is the retail or replacement value of the collateral:

> When a Chapter 11 debtor or a Chapter 13 debtor intends to retain property subject to a lien, the purpose of a valuation under section 506(a) is not to determine the amount the creditor would receive if it hypothetically had to foreclose and sell the collateral. Neither the foreclosure value nor the costs of repossession are to be considered because no foreclosure is intended. Instead, when the proposed use of the property is continued retention by the debtor, the purpose of the valuation is to determine how much the creditor will receive

for the debtor's continued possession. Hypothetical sales costs are not to be considered because no sale is intended.

In re Taffi, 96 F.3d at 1192. See also *In re Winthrop Old Farm Nurseries, Inc.*, 50 F.3d at 74; *In re Trimble*, 50 F.3d at 532; *In re McClurkin*, 31 F.3d at 404; *In re Coker*, 973 F.2d at 260; *In re Balbus*, 933 F.2d at 250-251.

In two recent decisions, however, the Second and Seventh Circuits disagreed with all of the prior decisions on the valuation of collateral under Section 506(a). These courts concluded that, when the collateral is to be retained and used by the debtor under the plan, the value of that collateral (and therefore the amount of the "secured claim" under Section 506(a)) is an amount halfway between (i) the retail price that a willing buyer in the debtor's position would be required to pay to obtain such property and (ii) the wholesale price for such property (even though that price would be unavailable to a buyer in the debtor's position). *In re Valenti*, No. 95-5079, 1997 WL 31577 (2d Cir. Jan. 15, 1997); *In re Hoskins*, 102 F.3d 311 (7th Cir. 1996).

In reaching this conclusion, the Seventh Circuit postulated a hypothetical bargaining process between a secured creditor with the power to foreclose and a debtor with the power to surrender the collateral and purchase a replacement. *In re Hoskins*, 102 F.3d at 315-316. In that situation, the court hypothesized, the outcome would be a bargain struck between foreclosure and replacement values because, at such a price, the creditor would be better off than if it had to foreclose and the debtor would be better off than if it had to replace the property. *Ibid.* Acknowledging

that "[t]here is no way to predict where in the bargaining range the bargain would be struck," the court adopted the midway point, or average of the two values, for ease of administration and predictability. *Id.* at 316. In *In re Valenti*, 1997 WL 31577 at *4-*6, the Second Circuit approved a similar "compromise" valuation of the collateral but held that the statute did not impose any specific valuation standard. Instead, the court reasoned that valuation is a factual issue and that a compromise valuation of property retained by the debtor is not an abuse of discretion. *Ibid.*

The "compromise" method of valuation approved by the Second Circuit in *Valenti* and mandated by the Seventh Circuit in *Hoskins* lacks support in either the logic or the text of the statute. The text of the statute directs that a "value" be determined—it does not direct that a compromise be struck. The possibility that a court might conclude that this statute could plausibly be interpreted in one of two ways would not support a ruling based solely upon a compromise between the alternatives. Such a "compromise" would not be a valid exercise of the court's duty to determine the meaning of the statute and to enforce it as written. Section 506(a) refers to a "value"; it does not refer to an average between two alternative valuations.

The authority granted to the debtor to retain and use the collateral is not based on any implicit or hypothetical bargaining with the creditor—instead, it is dependent solely upon compliance with the provisions of the Bankruptcy Code that require that the "value" of the secured claim be paid under the plan if the debtor is permitted to retain and use the collateral. See 11 U.S.C. 1325(a)(5); note 1, *supra*. Because it is the debtor who elects under the Bankruptcy Code

to retain the property or allow it to be sold, it is illogical for the debtor to contend that the "value" of the collateral retained is less than its replacement value. *In re Winthrop Old Farm Nurseries, Inc.*, 50 F.3d at 75. By proposing to retain the collateral the debtor has "acknowledged the value of the collateral to be greater than if liquidated." *In re Trimble*, 50 F.3d at 531.

Commercial property retained by the debtor has a readily discernible "value." That value is the cost that the debtor would incur in obtaining similar property for the same income-producing use—the price that a willing buyer in the debtor's position would pay a willing seller for the right to obtain and use such property. The debtor in this case would be required to purchase such property at retail and would not be able to purchase such property at wholesale. The "value" of the property in the debtor's hands is thus necessarily its retail price—for that is the price the debtor would be required tc pay for the right to use such property in its business. The wholesale price of property is not relevant in determining the "value" of such property in the hands of a retail buyer.

b. The use of retail or replacement value represents a rational allocation of bankruptcy risks when a debtor is permitted to retain property under a plan. Studies have shown that the majority of Chapter 13 plans fail. See *In re Rash*, 90 F.3d 1036, 1064 n.6 (5th Cir. 1996) (citing studies). Despite this substantial risk of default, the filing of a petition for relief in bankruptcy and the confirmation of a plan deprives a secured creditor of an important element of the protection that it bargained for: the state-law right to foreclose on its collateral. At the same time, the plan grants the debtor the benefits of using the collateral.

If the collateral is the debtor's personal residence, as it was in *Taffi*, 96 F.3d at 1191, these benefits will include housing and avoidance of the costs of moving; if the collateral is a wage-earner's personal car, as it was in *Hoskins*, 102 F.3d at 311, the benefits will include the use of the car in going to work; if the collateral is an income-producing asset, like the tractor-trailer truck here, the benefits include the income produced with the aid of the asset.

Whatever the nature of the collateral, the court may assume that it has value to the debtor, who has proposed to retain it under the plan. The replacement cost of the asset is the "value" that the debtor *actually*—not hypothetically—receives under the plan. *In re Rash*, 90 F.3d at 1062 n.1. By contrast, the creditor under such a plan will *actually* (not hypothetically) suffer a substantially increased risk of loss from the deferral in its recovery of the secured debt. *In re Taffi*, 96 F.3d at 1192-1193. The replacement cost of the collateral establishes its "value" when it is to be retained by the debtor, for it reflects "the economic benefit for the debtor" from its continued possession and "use of the collateral to generate an income stream" (*In re Winthrop Old Farm Nurseries, Inc.*, 50 F.3d at 75). It is thus accurate and proper—and neither unfair nor inequitable—to recognize that the "value" of the property being used for this purpose is the cost that the debtor would be required to pay to obtain an identical asset for the same "proposed * * * use" (11 U.S.C. 506(a)). See *In re Taffi*, 96 F.3d at 1192.

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted.

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No. 96-454

In The

Supreme Court of the United States

October Term, 1996

ASSOCIATES COMMERCIAL CORPORATION,

Petitioner,

v.

ELRAY RASH AND JEAN RASH,

Respondents.

On Writ Of Certiorari To The United States Court Of Appeals For The Fifth Circuit

BRIEF AMICI CURIAE IN SUPPORT OF PETITIONER

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QUESTION PRESENTED FOR REVIEW

Whether, when a debtor proposes to retain a secured creditor's collateral under the cramdown powers of Chapter 13 of the Bankruptcy Code, the amount required to be paid on account of the creditor's secured claim is limited to the value that the secured creditor could have obtained if it had sold the collateral at foreclosure.

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INTEREST OF AMICI CURIAE

NationsBank, N.A., NationsBank, N.A. (South), NationsBank of Texas, N.A., Bank of America Texas, N.A., Bank of America National Trust and Savings Association, BANC ONE CORPORATION and The Chase Manhattan Bank USA, N.A. (collectively the "Banks") hereby respectfully file their brief *amici curiae* in this case. The consent of the attorneys for the Petitioner and the Respondent has been obtained.

The United States Court of Appeals for the Fifth Circuit (the "Court of Appeals"), in an *en banc* opinion, held that the value of a secured claim is limited to the amount the secured creditor could realize from a hypothetical sale of its collateral even when a Chapter 13 debtor proposes to retain such collateral for personal use. *Associates Commercial Corp. v. Rash (In re Rash)*, 90 F.3d 1036 (5th Cir. 1996) (the "Decision"). The interest of the Banks in this case arises from the direct detrimental effect the Decision has on the value of secured loans held by the Banks. The Banks support the view expressed by the six dissenting Circuit Judges in *Rash* that 11 U.S.C. § 506(a) (1995) (all statutory references contained herein refer to the United States Bankruptcy Code, Title 11, United States Code) requires a bankruptcy court to value retained collateral in a Chapter 13 case based on its replacement rather than wholesale cost. If the decision below is upheld, the value of virtually all claims secured by personal property, including vehicles, in Chapter 13 cases will be based on wholesale values even when debtors choose to retain and use such collateral during and subsequent to their bankruptcy proceedings.

The extent of the detrimental effect of the Decision on the Banks is best illustrated by the number and value

of their claims in Chapter 13 bankruptcy cases. NationsBank, N.A., NationsBank N.A. (South) and NationsBank Texas, N.A. (collectively "NationsBank") were creditors in 7,788 pending Chapter 13 bankruptcy cases as of December 31, 1996.[1] Approximately 45% of these Chapter 13 cases involve personal property collateral that was retained for use by debtors. The retail or replacement value of the collateral being retained and used by the debtors in these cases averaged $11,800.00 per case. Thus, valued on a retail basis, the total approximate amount of these secured claims was $41,350,000.00. Considering an average difference of 20-25% between retail and wholesale values,[2] application of the valuation standard mandated by the Decision would have cost NationsBank alone between $8,500,000.00 and $10,000,000.00 had that standard been applied to all cases now pending.

[1] These statistics do not include the more than 6,000 consumer bankruptcies (Chapter 7 and Chapter 13) that were transferred to NationsBank upon its acquisition of Boatmen's Bancshares, Inc. and its subsidiaries.

[2] A review of recent editions of N.A.D.A. Official Used Car Guide, a recognized industry publication used for valuing automobiles, indicates that the wholesale or foreclosure value of a vehicle is approximately 20-25% lower than its retail, or replacement, value.

The Chase Manhattan Bank USA, N.A.'s indirect[3] automobile portfolio contains approximately $50 million in bankruptcy claims; of these, approximately 23% are asserted in Chapter 13 cases. The total amount of Chapter 13 autofinancing claims is approximately $20 million. In addition to these claims, Texas Commerce Bank (a Chase affiliate) had 889 new bankruptcy cases in 1996 involving loans secured by automobiles with total claim amounts of $11,848,860.00. Of the claims secured by automobiles, 383 were asserted in Chapter 13 cases. These Chapter 13 claims have a total balance of $5,428,816.00.[4]

Bank of America National Trust and Savings Association and its subsidiaries ("Bank of America") are currently in the same position as the Petitioner in at least 1,103 pending Chapter 13 cases. In each of these cases, Bank of America's claim is secured by an automobile that has been retained by the debtor, and the claim (both the secured and unsecured portions) is being paid through the Chapter 13 reorganization plan. Those claims have a total value of approximately $7.8 million. The total amount of claims held by Bank of America in newly filed

[3] The indirect automobile portfolio includes all retail installment sales contracts secured by automobiles which have been assigned to Chase Manhattan by automobile dealerships from across the country.

[4] Together the Chase Manhattan indirect portfolio and the Texas Commerce Bank portfolio account for most, but not all, of the claims held by Chase's affiliates. For example, Chase Financial Corporation holds claims secured by automobiles in 110 Chapter 13 cases. The total dollar amount of these claims is unavailable.

consumer cases, excluding credit card debt, in 1996 was at least $33.8 million.

The significance of the valuation standard applied in the Decision will increase as the number of consumer bankruptcy filings continues to rise. As tracked by the Administrative Office of the United States Courts, Chapter 13 filings across the country increased by 9% during the twelve-month period ending September 30, 1995, from the previous fiscal year. Administrative Office of The United States Courts, *1995 Annual Survey*, Table F-2. During the following twelve months, Chapter 13 filings increased another 23.9% to a record high of 336,615 filings. Administrative Office of The United States Courts, *1996 Annual Survey*, Table F-2. Despite a generally expanding economy and low unemployment, the number of consumer filings has more than tripled since 1980. *Written Statement of American Banker's Association et al. before the National Bankruptcy Review Commission*, December 17, 1996 (hereinafter *Statement to N.B.R.C.*). The Banks expect this trend to continue in 1997 and beyond; thus, the impact of this Court's decision on the value of secured claims will be even more significant as the number of personal bankruptcies rises.

Lenders determine the cost of credit based in part on their estimate of costs or losses that will be caused by future events. *See* Ronald J. Mann, *Explaining the Pattern of Secured Credit*, 110 Harv. L. Rev. 625, 635, 637 n. 40 (1997). If the Decision is upheld, the Banks will face an increase in such costs created by the change in the standard for valuation of secured claims. The losses which will be incurred by the Banks and other consumer finance companies will also affect customers seeking secured

credit. Lenders will likely adjust the price of all consumer loans to account for the change in the potential losses caused by bankruptcy filings. *Id.* Although not currently quantifiable, bankruptcy losses of this magnitude will be passed on to consumers in the form of higher interest rates and decreased availability of credit. *Statement to N.B.R.C.* Thus, the outcome of this case has direct and substantial financial consequences for the Banks, other entities providing secured credit, and the customers they serve.

SUMMARY OF ARGUMENT

When construed as a whole, § 506(a) of the Bankruptcy Code requires courts to value retained collateral based on its replacement rather than wholesale value to determine the amount of an allowed secured claim during plan confirmation. Correctly construed, the first sentence of this subsection describes what courts should value in determining the amount of a secured claim and the second directs how the valuation should be made. The Court of Appeals erred by not viewing the subsection as a whole and by limiting the value of a secured claim to liquidation cost even when the debtor intends to retain and use the creditor's collateral.

Valuing a secured claim for the purposes of Chapter 13 plan confirmation based on a hypothetical sale by the creditor is incorrect given the directive found in the second sentence of § 506(a) to value the claim "in light of the purpose of the valuation and of the proposed disposition or use" of the collateral. This directive allows courts the

flexibility needed to value claims in the myriad of contexts that arise under the Bankruptcy Code. The Decision will result in secured claims being valued at a liquidation level regardless of the circumstances surrounding the valuation. This result is contrary to the meaning and purpose of § 506(a).

Limiting the standard of valuation to wholesale values not only violates the dictates of § 506(a), but also ignores important attributes of a secured creditor's interest in collateral. Liquidation of collateral is not the only right to which secured creditors are entitled and does not provide the only measure of a claim's worth. Rather, secured creditors realize the value of their lien through a variety of means established by contract or state law. In this case, ignoring the debtor's election to retain the collateral through the proceeding and after the conclusion of the case fails to account for an important fact bearing on the worth of the collateral securing the creditor's claim. The rule announced by the Court of Appeals effectively transfers the difference between the wholesale and replacement value to unsecured creditors at the expense of the secured creditor and in derogation of the valuation requirements of § 506(a).

ARGUMENT

I. THE COURT OF APPEALS FAILED TO CONSTRUE § 506(a) AS A WHOLE.

A. Both Sentences of § 506(a) Should Be Read Together When Valuing Secured Claims.

When construed as a whole in the context of plan confirmation, § 506(a) of the Bankruptcy Code compels the valuation of retained collateral based on its replacement rather than wholesale value. Section 506(a) provides in relevant part:

> An allowed claim of a creditor secured by a lien on property in which the estate has an interest . . . *is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property,* . . . and is an unsecured claim to the extent that the value of such creditor's interest . . . is less than the amount of such allowed claim. *Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property,* and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor's interest.

11 U.S.C. § 506(a) (emphasis added). Correctly construed, the first sentence of this subsection describes what courts should value in determining the amount of a secured claim and the second directs how the valuation should be made. *Taffi v. United States (In re Taffi)*, 96 F.3d 1190, 1192 (9th Cir. 1996) (overruling *General Motors Acceptance Corp. v. Mitchell (In re Mitchell)*, 954 F.2d 557 (9th Cir. 1992)); *Rash*, 90 F.3d at 1061 (Smith, J., dissenting); *Metrobank v. Trimble (In re Trimble)*, 50 F.3d 530, 531 (8th Cir. 1995);

Coker v. Sovran Equity Mortgage Co. (In re Coker), 973 F.2d 258, 260 (4th Cir. 1992); *In re Chateaugay Corp.*, 154 B.R. 29, 33 (Bankr. S.D.N.Y. 1993). As stated by Judge Lifland in *Chateaugay*, statutory construction "'is a holistic endeavor' . . . and it is necessary to examine § 506(a)'s second sentence before reaching any conclusion with respect to the meaning" of the first. 154 B.R. at 33 (quoting *United Sav. Ass'n v. Timbers of Inwood Forest Assocs.*, 484 U.S. 365, 371 (1988)).

The Court of Appeals erred in concluding that the first sentence of § 506(a) both describes what is being valued and dictates how it should be valued. *Rash*, 90 F.3d at 1044-45. As acknowledged by the Decision, the first sentence is broadly drafted to encompass the many potential property interests encountered in bankruptcy cases as well as the fact that both senior and junior lien holders' secured claims are valued under its provisions. *Rash*, 90 F.3d at 1043. Specifically, the use of the phrase "creditor's interest" in the first sentence is not meant to limit how a secured claim should be valued, but instead serves "to remind us that a lien is not co-extensive with the property that it is a lien on." *In re Hoskins*, 102 F.3d 311, 314 (7th Cir. 1996); *see also Rash*, 90 F.2d at 1061 (Smith, J. dissenting).

This Court has repeatedly stated that the first sentence of this section simply means that the amount of the secured claim is equal to the value of the creditor's collateral, without ever suggesting that it establishes a standard for valuation as well. *United Sav. Ass'n v. Timbers of Inwood Forest Assocs.*, 484 U.S. 365, 372 (1988) (concluding that the phrase "value of such entity's interest" found

in § 361 means the value of a secured creditor's collateral); *United States v. Ron Pair Enters.*, 489 U.S. 235, 239 (1989); *Nobelman v. American Sav. Bank*, 508 U.S. 324 (1993) (allowed claim secured by a lien on debtor's property "is a secured claim to the extent of the value of [the] property"); *see also Dewsnup v. Timm*, 502 U.S. 410 (1992) (Scalia, J. dissenting). Indeed in *Timbers*, this Court elaborated that the reference to the creditor's interest in property in the first sentence "obviously means his security interest without taking account of his right to immediate possession of the collateral on default." 484 U.S. at 372. Thus, this Court has stated that the first sentence of § 506(a) identifies what should be valued without mandating how it should be valued.

The second sentence describes what factors must be considered in valuing the secured portion of a claim and when that valuation should occur. 11 U.S.C. § 506. The factors identified by the second sentence are (1) the purpose of the valuation and (2) the proposed use or disposition of the collateral. *Id.* When a debtor intends to retain collateral subject to a security interest, the debtor cannot reduce the value of a secured claim by approximating costs of a hypothetical sale, nor can the debtor limit the value of the secured claim to the price that could be obtained in a hypothetical liquidation sale. *Winthrop Old Farm Nurseries, Inc. v. New Bedford Inst. for Sav. (In re Winthrop Old Farm Nurseries, Inc.)*, 50 F.3d 72, 75 (1st Cir. 1995) (valuing junior mortgage holder's claim in Chapter 11); *Taffi*, 96 F.3d at 1192 (valuing IRS lien on real property in Chapter 11); *Huntington Nat'l Bank v. Pees (In re McClurkin)*, 31 F.3d 401, 405 (6th Cir. 1994) (valuing junior mortgage holder in Chapter 13); *Brown & Co. Securities Corp. v. Balbus (In re Balbus)*, 933 F.2d 246, 252 (4th

Cir. 1991) (valuing judgment lien encumbering real property in Chapter 13).

Courts have consistently held that personal property must be valued with reference to its actual use when determining the amount of a creditor's secured claim in Chapter 13. *Trimble*, 50 F.3d at 531-32; *In re Green*, 151 B.R. 501, 506 (Bankr. D. Minn. 1993); *In re Dews*, 191 B.R. 86, 90 (Bankr. E.D. Va. 1995); *In re Reynolds*, 17 B.R. 489 (Bankr. N.D. Ga. 1981) (each valuing automobiles in Chapter 13). *Cf. Taffi*, 96 F.3d at 1193 (determining that automobiles should be valued at fair market value but leaving determination of fair market value to the bankruptcy courts). In the context of Chapter 13 cases involving automobiles, these courts have reasoned that valuing the collateral based on a hypothetical sale by the creditor is inconsistent with the directive found in the second sentence to value the claim "in light of the purpose of the valuation and of the proposed disposition or use" of the collateral. *Trimble*, 50 F.3d at 531-32; *Green*, 151 B.R. at 506; *Dews*, 191 B.R. at 90; *Reynolds*, 17 B.R. at 493. As stated by the United States Court of Appeals for the Ninth Circuit in *Taffi*, "when the proposed use of the property is continued retention by the debtor, the purpose of the valuation is to determine how much the creditor will receive for the debtor's continued possession." 96 F.3d at 1192.

This application of each sentence of § 506(a) allows courts the flexibility in valuing collateral that was intended by Congress.[5] Section 506(a) governs valuation

[5] Section 506(a)'s second sentence was initially found only in the Senate bill. *Compare* H.R. 8200, 95th Cong., 1st Sess. (1977)

of secured claims in numerous contexts in Chapters 7, 11, 12 and 13 of the Bankruptcy Code. 11 U.S.C. § 103. Courts should not be forced to use a single valuation standard in pursuit of the particular goals of each of those chapters. *See Hoskins*, 102 F.3d at 314. In addition, within each chapter, § 506(a) is employed to value secured claims for multiple purposes. The standard employed for determining value must depend on why the valuation is being made and the contemplated use of the collateral.[6] Moreover, § 506(a) governs the valuation of every kind of collateral possessed by debtors in each of these chapters. Its application is not restricted to real estate or automobiles; rather the section has been used to value boats, aircraft, pension benefits and other tangible and intangible personal property. *See, e.g.*, *In re Perkins*, 134 B.R. 408, 411-12 (Bankr. E.D. Col. 1991); *In re Fiberglass Indus., Inc.*, 74 B.R. 738, 740 (Bankr. N.D.N.Y. 1987).

and S.2266, 95th Cong., 2nd Sess. (1978). The report accompanying the Senate bill notes that "courts will have to determine value on a case by case basis" and "[t]hroughout the bill, references to secured claims are only to the claim determined to be secured under this subsection, and not to the full amount of the creditor's claim." S. Rep. No. 989, 95th Cong., 2nd Sess. (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5854.

[6] For example, in comparing the value provided to creditors under a reorganization plan with what would be available in a Chapter 7 liquidation, courts have properly valued estate assets at wholesale or quick sale prices and have taken into account hypothetical trustee expenses and capital gains taxes. *See, e.g.*, *In re Riveria*, 116 B.R. 17 (Bankr. D. P.R. 1990); *In re Young*, 153 B.R. 886 (Bankr. D. Neb. 1993).

The wide variety of contexts in which bankruptcy courts apply the section and the diverse types of property valued demonstrate the importance of employing a standard based on the purpose of valuation and the proposed use or disposition of the collateral. The interpretation of § 506(a) employed by the Court of Appeals fails to provide such flexibility. If collateral is valued at wholesale cost when the debtor proposes to use the collateral through the proceeding and subsequent to plan completion, then there is no context within which a fair market value or replacement costs standard would ever be appropriate.

The Court of Appeals' reading of the statute leaves courts with a single valuation standard regardless of the circumstances. The section should be read as a whole so that it may be sensibly applied in the broad variety of contexts in which valuation arises under the Bankruptcy Code. When valuing secured claims for the purposes of plan confirmation under Chapter 13, those courts that have considered the language of § 506(a) as a whole have correctly concluded that valuation must be made in light of the debtor's intention to continue to use and enjoy the collateral.

B. The Decision Deprives the Second Sentence of Any Meaning and Ignores its Mandatory Language.

The Court of Appeals held that in every case the first sentence of § 506(a) requires a court to value only the secured creditor's right to repossess collateral and to exercise its rights under state law with respect to the

collateral. *Rash*, 90 F.3d at 1044. The Court of Appeals summarized its reasoning as follows:

> Ultimately it is the creditor's interest that is being valued under § 506(a), and such evaluation must account for the fact that the creditor's interest is in the nature of the security interest, giving the creditor the right to repossess and sell the collateral and nothing more. Therefore, the evaluation should start with what the creditor could have realized by exercising that right.

Id. Unfortunately, the value of the collateral "in the hands of the creditor" – regardless of its proposed use – is both the beginning and ending of the Court of Appeals' analysis.

The Court of Appeals' interpretation of the first sentence of § 506(a) renders the second sentence without purpose. Wherever possible, statutes should be construed so as to give effect to every part of the statute. *Rake v. Wade*, 508 U.S. 464, 113 S. Ct. 2187 (1993) (superseded by statute on other grounds). One provision should not suspend or supersede another. *Id*. at ___, 113 S. Ct. at 2192. The meaning ascribed to the first sentence of § 506(a) by the Court of Appeals violates this basic canon of statutory construction and ignores the mandatory language of the second sentence.

When valuation is undertaken in the context of plan confirmation and the debtor proposes to retain and use the collateral through the proceeding and following its conclusion, the plain meaning of the second sentence requires a court to value the collateral in light of that use. *Trimble*, 50 F.3d at 532. *Cf. In re Valenti*, No. 95-5079, 1997 U.S. App. LEXIS 647, *10 (2d Cir. January 15, 1997)

(acknowledging that value of creditor's allowed secured claim must account for replacement cost of collateral).[7] The use of the word "shall" generally means that the congressional directive is mandatory rather than permissive. *Gutierrez de Martinez v. Lamagno*, 115 S. Ct. 2227, 2235 n.9 (1995); *Nantucket Investors II v. California Fed. Bank (In re Indian Palms Assocs., Ltd.)*, 61 F.3d 197, 207 (3rd Cir. 1995) (construing 11 U.S.C. § 362(d)). There is no suggestion in the text or the legislative history that courts may choose whether or not to consider these factors.[8] Instead, bankruptcy courts must account for them in their valuations.

Courts that value automobiles in light of their proposed use by debtors have determined that a replacement or retail valuation standard is appropriate. *Trimble*, 50 F.3d at 532. In the context of the cramdown of a plan

[7] In *Valenti*, the Court of Appeals for the Second Circuit upheld application of a local Northern District of New York rule which fixes value of retained vehicles in Chapter 13 cases at the average of wholesale and retail values absent contrary evidence of the vehicle's worth. While this is a convenient rule, it is not the method of valuation required by Section 506(a).

[8] A single valuation standard is inconsistent with the intent evidenced by the legislative history of the first sentence alone. Although the House bill did not contain the second sentence, the comments to this subsection of House Bill 8200 nonetheless stated: "'Value' does not necessarily contemplate forced sale or liquidation value of the collateral; nor does it always imply a full going concern. Courts will have to determine value on a case by case basis, taking into account the facts of each case and the competing interests in each case." H.R. Rep. No. 595, 95th Cong., 1st Sess. (1977), *reprinted in* 1977 U.S.C.C.A.N. 5963, 6312.

under § 1325, "the purpose of the valuation is to determine the amount the undersecured creditor will be paid for the debtor's continued use and possession of the vehicle which secured the debtor's obligation. The value of the creditor's interest in such cases is derived from the stream of payments the collateral secures" rather than a repossession and sale of the collateral. *Green*, 151 B.R. at 506. In Chapter 13 cases where the debtor proposes to keep the collateral, the value of the secured creditor's claim must be determined with reference to this use rather than a hypothetical disposition that will not take place under the plan. *Dews*, 191 B.R. at 90. A replacement or retail standard for valuation is the correct measure of a vehicle's value in this context.[9] This standard accounts for what a debtor would have to pay in the market place for an automobile of the same model, age and condition.[10] Section 506(a) requires courts to value secured claims in light of the purpose of the valuation and the proposed use of the collateral. In this case, the Court of

[9] Perhaps the most universally recognized source of valuation for used automobiles is the N.A.D.A. Official Used Car Guide. *In re Marshall*, 181 B.R. 599, 604 n.9 (Bankr. N.D. Ala. 1995). The N.A.D.A. Guide contains a "retail" value and a "wholesale" value, which are based on those kinds of sales in the region for which the Guide is published. Publisher's Note, N.A.D.A. Official Used Car Guide, Eastern Edition, February, 1997.

[10] All N.A.D.A. values (whether retail or wholesale) assume the vehicle is clean. *Id.* An exceptionally clean vehicle or one which bears a warranty or guarantee should bring a greater price than the given value, while vehicles that must be reconditioned to be in salable condition will bring less than the average value. *Id.*

Appeals erred by disregarding the proposed use of the vehicle in its determination of the standard for valuing the Petitioner's secured claim.

II. USE OF WHOLESALE VALUATION TRANSFERS THE VALUE OF COLLATERAL FROM SECURED TO UNSECURED CREDITORS.

Limiting the method of valuing collateral to a liquidation price not only violates the dictates of § 506 but also ignores important attributes of a secured creditor's interest in collateral. Although a secured creditor has the right under non-bankruptcy law to repossess and sell its collateral upon default, this right "does not automatically mean that the value of the lien is equivalent to the amount the creditor would receive upon disposition of the collateral in satisfaction of its lien." *Trimble*, 50 F.3d at 531 (quoting *Green*, 151 B.R. at 505). Moreover, a creditor can realize the value of its lien in several ways: by a repossession and sale of the collateral, through receiving a stream of payments on the obligation underlying the security, or by agreeing to a consensual sale. *In re Jones*, 152 B.R. 155, 185 (Bankr. E.D. Mich. 1993) (methods other than repossession do not require creditor to absorb costs of a forced sale); *Green*, 151 B.R. at 505.[11] By choosing to

[11] Where residential real property serves as collateral, this Court has recognized that the rights of a secured creditor "include the right to repayment of the principal in monthly installments over a fixed term at specified adjustable rates of interest, the right to retain the lien until the debt is paid off, the right to accelerate the loan upon default and to proceed against petitioners' residence by foreclosure and public sale, and the

retain the property, the debtor is acknowledging its value to be greater than liquidation or wholesale price. *In re Penz*, 102 B.R. 826, 828 (Bankr. E.D. Okla. 1989) (valuing farm land in Chapter 12 proceeding). Similarly, the creditor's interest is "enhanced by the proposed continued use of the property to help maintain employment and thereby effectuate the debtors' performance under the plan." *Green*, 151 B.R. at 505; *Dews*, 191 B.R. at 90. *Cf. General Motors Acceptance Corp. v. Mitchell (In re Mitchell)*, 954 F.2d 557, 561 (9th Cir. 1992) (Noonan, J., dissenting), *overruled by In re Taffi*, 96 F.2d 1190 (9th Cir. 1996). In his dissent in *Mitchell*, Judge Noonan noted, "[t]here is no better way of arriving at its value 'in the light of . . . its proposed use' than to determine the cost of a similar car." 954 F.2d at 561. The debtor's decision to continue to use collateral for his or her benefit necessarily affects the value of the collateral to both debtor and creditor. *See Mann*, *supra*, at 646-648 (noting value of collateral's use to debtor underlies creditor's pre-loan perception of risks and costs). This value cannot be ignored in determining the amount of the lien holder's secured claim for the purposes of plan confirmation.

In this case, ignoring the debtor's election to retain the collateral fails to account for a fact which bears on the worth of the collateral securing the creditor's claim and on the worth of the secured claim itself. This Court has

right to bring an action to recover any deficiency remaining after foreclosure." *Nobelman v. American Sav. Bank*, 508 U.S. at 329.

previously recognized that real property sold at a foreclosure sale cannot be valued in the same way as property sold in the ordinary course. *BFP, Inc. v. Resolution Trust Corp.*, 511 U.S. 531 (1994) (properly conducted foreclosure yields "reasonably equivalent value" for foreclosed property). This Court concluded that property "that *must* be sold within those strictures is simply *worth less*." *Id.* at 565 (emphasis in the original). The fact that property is subject to forced sale, "like any other fact bearing upon the property's use or alienability, necessarily affects its worth." *Id.* at 571. In the context of valuation pursuant to § 506(a), valuing retained collateral as if it were being liquidated results in the same incongruity as valuing foreclosed property as if it were being sold on an open market.

Value is defined and determined "in a particular situation from the purpose for which a valuation is being made." *Group of Institutional Investors v. Chicago, M., St. P. & P. R.*, 318 U.S. 523, 540 (1943) (valuing interest of equity holders in railroad reorganization case). In a Chapter 13 reorganization, the use of an automobile is usually essential to the success of the completion of the plan. *Marshall*, 181 B.R. at 603; *Reynolds*, 17 B.R. at 493 (retaining vehicle enables the debtors to avoid the necessity of replacement transportation).

Even prior to the enactment of the current Bankruptcy Code, courts recognized the unique importance of a vehicle to the Chapter 13 debtor and thus to the debtor's creditors. *In re Rutledge*, 277 F. Supp. 933 (E.D. Ark. 1967); *In re Pizzolato*, 268 F. Supp. 353 (W.D. Ark.

1967). In *Pizzolato*, the district court upheld the bankruptcy referee's decision to enjoin foreclosure of the debtor's vehicle because its use was necessary for the "stability of the proposed plan and without it the plan would collapse." 268 F. Supp at 354; *see also Rutledge*, 277 F. Supp. at 935 (conditioning injunction on debtor implementing repayment plan for full contract amount).

The Decision transfers this enhanced value of the collateral to the debtor's unsecured creditors in every reorganization case without acknowledging the true value of the creditor's interest in the collateral.[12] *Rash*, 90 F.3d at 1064 (Smith, J. dissenting). The difference between wholesale and retail price (or liquidation and fair market value) is generally paid to unsecured creditors through the reorganization plan because Chapter 13 requires a debtor to commit his or her disposable income to the plan for a period of three to five years.[13] 11 U.S.C. §§ 1322, 1325. This transfer is not justified given that the use of the collateral often makes the reorganization possible. Just as increases in collateral value during the pendency of a case accrue to the benefit of the secured creditor, a secured claim should be valued at confirmation to allow

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[12] The losses borne by secured creditors as a result of this transfer will be felt by non-bankrupt consumers as well. As noted in the lending industry's statement to the National Bankruptcy Review Commission, bankruptcy losses mean higher credit costs and lower credit availability to all customers. *Statement to N.B.R.C.* at 2, 6 and 7.

[13] It is also possible for the debtor to realize this difference by selling the collateral for greater than wholesale value following plan confirmation. *See Winthrop*, 50 F.3d at 75.

the creditor full compensation for the value of its collateral. *See Dewsnup*, 502 U.S. at 417 (increases in value of collateral should benefit secured creditor rather than unsecured creditors or debtor).

Allowing a debtor to value an automobile at a liquidation or wholesale price when it will be used throughout the debtor's performance under his reorganization plan and following the debtor's discharge ignores the value of that use to the debtor and his creditors. The difference between the wholesale and replacement value is effectively transferred to unsecured creditors and the true value of the secured creditor's collateral, as well as that creditor's contribution to the reorganization, goes unrecognized.

CONCLUSION

For these reasons, the decision of the Court of Appeals should be reversed.

Respectfully submitted this 26th day of February, 1997.

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(11)

No. 96-454

In The

Supreme Court of the United States

October Term, 1996

ASSOCIATES COMMERCIAL CORPORATION,

Petitioner,

v.

ELRAY RASH and JEAN E. RASH,

Respondents.

**On Writ Of Certiorari
To The United States Court Of Appeals
For The Fifth Circuit**

BRIEF OF AMICI CURIAE IN SUPPORT OF PETITIONER

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BRIEF OF AMICI CURIAE IN SUPPORT OF PETITIONER

The American Automobile Manufacturers Association, Inc. ("AAMA"), the Association of International Automobile Manufacturers, Inc. ("AIAM") and the American Financial Services Association ("AFSA") submit this Brief of Amici Curiae in Support of Petitioner. This brief is filed under Rule 37.3(a). The written consents of all parties to the filing of this brief have been filed with this Court's clerk.

I

INTEREST OF AMICI CURIAE

AAMA is an association of the three major American car manufacturers, Ford Motor Company, General Motors Corporation and Chrysler Corporation which together produce more than 80% of the cars manufactured in the United States. Through their finance subsidiaries, each of the AAMA's members finances the purchase of millions of cars each year. Each year, the AAMA's members are involved, as undersecured creditors, in tens of thousands of Chapter 13 bankruptcy cases, most of which involve the valuation issue presented by this case.

AIAM is a trade association representing United States subsidiaries of international automobile companies, including American Honda Motor Co., Inc., American Suzuki Motor Corporation, BMW of North America, Inc., Daewoo Motor Co., Ltd., Fiat Auto U.S.A., Inc., Hyundai Motor America, Isuzu Motors America, Inc., Kia Motors America, Inc., Land Rover North America, Inc., Mazda Motor of America, Inc., Mitsubishi Motor

Sales of America, Inc., Nissan North America, Inc., Peugeot Motors of America, Inc., Porsche Cars North America, Inc., Rolls-Royce Motor Cars, Inc., Subaru of America, Inc., Saab Cars USA, Inc., Toyota Motor Sales U.S.A., Inc., Volkswagen of America, Inc., and Volvo North America Corporation. Like the members of the AAMA, these international car makers finance the purchase of thousands of cars and are likewise involved in thousands of Chapter 13 cases annually, in most of which the car's value is in issue.

AFSA is the nation's largest trade association representing non-bank providers of consumer financial services. Organized in 1916, AFSA represents more than 360 companies operating over 10,000 offices engaged in extending consumer credit. AFSA's members include credit card issuers, independently-owned consumer finance companies, diversified financial services companies, and automobile finance companies. Consumer finance companies hold over $190 billion of outstanding consumer credit and over $50 billion in second mortgage credit representing one quarter of all consumer credit outstanding in the United States.

Amici and their members have a vital interest in the outcome of the issue raised in this case. Members of amici are involved as secured creditors in thousands of Chapter 13 proceedings each year. In 1995 alone, over 286,000 new Chapter 13 cases were filed. Bankruptcy Statistical Information, *reprinted in* 1995 Admin. Off. Of U.S. Cts., JCUS Rep. 93, Table F-2.

Most of those proceedings involve the valuation issue which this case raises. Most commonly, the debtor's

car is the focus of the valuation dispute. Consumer debtors need their cars to continue working and living a normal modern life. Hence, most Chapter 13 plans provide for the debtor to retain his or her car and pay the creditor reduced monthly principal payments based on the car's value, as determined under 11 U.S.C. § 506(a).

If the debtor retained his or her car in just half of the new Chapter 13 cases last year and the average difference between wholesale and retail value was $2,000, the choice between these valuation standards would have made a $286 million difference to debtors and creditors in 1996 alone. Creditors cannot simply "absorb" losses of this magnitude. Creditors' losses inevitably increase the cost of credit to all borrowers, solvent and insolvent alike.

The standard of valuation under 11 U.S.C. § 506(a) affects all collateral, not just cars, and all types of bankruptcy cases, not just Chapter 13 filings. Homes and other real property must also be valued to determine how much of a creditor's claim is secured.[1] Many of amici's members also provide financing secured by these other forms of collateral. The standard for valuation of collateral retained by a debtor under a Chapter 13 plan should be the same no matter what type of property is involved. Cars should not be valued by one standard, homes by another, and equipment or other assets by a third.

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[1] Valuation of the debtor's home is less commonly an issue in Chapter 13 cases because 11 U.S.C § 1322(b)(2) does not permit a Chapter 13 plan to modify the rights of a creditor whose only security is the debtor's home. *Nobleman v. American Savings Bank*, 508 U.S. 324, 113 S.Ct. 2106, 124 L.Ed.2d 228 (1993).

For all of these reasons, amici have a vital interest in the issue raised in this case.

II
SUMMARY OF ARGUMENT

Section 506(a) of the Bankruptcy Code provides that a creditor's allowed claim

> is a secured claim to the extent of the value of *such creditor's interest in the estate's interest in the collateral*. . . . Such value shall be determined *in light of* the purpose of the valuation and of *the proposed disposition or use of such property*. . . . (Emphasis added.)

Properly construed, § 506(a)'s two sentences provide a clear, consistent, and coherent directive as to how a court is to value the secured portion of an undersecured creditor's claim. The section's first sentence identifies ***what*** is to be valued: "the creditor's interest in the estate's interest in the collateral." The second sentence states ***how*** the value of the creditor's interest is to be determined: "in light of the purpose of the valuation and of the proposed disposition or use of such property."

The Court of Appeal's majority opinion incorrectly reads more into § 506(a)'s first sentence, wrongly equating "the creditor's interest" with the right to foreclose upon and sell the collateral. *United Savs. Ass'n v. Timbers of Inwood Forest Assoc.*, 484 U.S. 365, 108 S.Ct. 626, 98 L.Ed.2d 740 (1988) ("*Timbers*") teaches that § 506(a) cannot be so read. Doing so, nullifies § 506(a)'s second sentence. Moreover, under standard non-bankruptcy law, the creditor's interest indisputably comprehends more

than simply the right to foreclose and sell. *See Nobleman v. American Savings Bank, supra*, 113 S.Ct. at 2109-10 (secured creditor's "rights" include more than the right to foreclose).

Once the function of § 506(a)'s first sentence is properly understood, the role of its second sentence becomes clear, too. The collateral must be valued "in light of the purpose of the valuation and of the proposed disposition or use of such property."

If the debtor proposes to retain and use the collateral, the collateral must be valued in light of that proposed use. Its value is the amount that the debtor or others in his or her position would pay to obtain the property; that is, the collateral's fair market value in the market in which the debtor would buy such goods.[2] If the debtor owns less than a full fee interest or the creditor's interest is limited, the value of those limitations must be established in the same manner and be subtracted from the collateral's value to derive the value of the "creditor's interest."

Interpreting § 506(a) in this manner not only reconciles its provisions into a harmonious whole, but also furthers Congress' stated intention of allowing creditors to share in the enhanced value generated by a debtor's proceeding under Chapter 13 rather than under Chapter 7. Granting secured creditors a portion of the enhanced

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[2] For example, if the debtor proposes to retain and use a car, the value of the secured portion of the creditor's claim in that car is the fair market value of that car in the used car market in which debtor could buy an identical car if unable to retain his or her own.

value due to reorganization compensates them, in part, for the increased risks they incur in reorganization. This represents no windfall to creditors. Valuation is primarily of concern when the creditor is undersecured, as petitioner is in this case. In this case, as in the typical Chapter 13 case, the debtor pays little or nothing on unsecured claims. Undersecured creditors, therefore, usually lose most of the unsecured part of debt; that is, the amount that exceeds the collateral's value. In addition, undersecured creditors have additional credit risks under Chapter 13 plans. Those risks are particularly acute when the collateral is a rapidly depreciating asset such as a car. Less than a third of Chapter 13 debtors complete their plans. In the other two-thirds of the Chapter 13 cases, creditors often suffer further losses upon later repossessing collateral which has not been adequately maintained or insured during the pendency of the Chapter 13 case.

Finally, the valuation issue cannot properly be resolved by splitting the difference between wholesale and retail values, as the Seventh Circuit has suggested, *In re Hoskins*, 102 F.3d 311 (7th Cir. 1996), or by leaving bankruptcy courts to choose any value they please between wholesale and retail values, as the Second Circuit has more recently held, *In re Valenti*, ___ F.3d ___, 1997 WL 31577 (2d Cir. 1997). Both of these approaches fail to accord coherent meaning to § 506(a), engaging in judicial legislation to fill the gap they wrongly perceive in the statute that Congress enacted.

For all of these reasons, amici urge the Court to reverse the Court of Appeal decision in this case and hold that for purposes of valuing the secured portion of an undersecured creditor's claim, collateral retained by a debtor under a Chapter 13 plan must be valued at its fair market value in the market in which the debtor would, but for the Chapter 13 plan, acquire identical property.

III
PROPERLY INTERPRETED, SECTION 506(a) IS A CONSISTENT WHOLE

A. Section 506(a)'s First Sentence Identifies What Is To Be Valued

1. The Court Must Value The Collateral, Deducting For Limitations In The Estate's Or The Creditor's Interest In That Collateral

Section 506(a)'s first sentence states that a creditor's allowed claim secured by a lien on the estate's property "is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property."

This sentence marks the dividing line between the secured and unsecured portions of an undersecured creditor's claim. It states ***what*** the bankruptcy court must value in order to determine how much of a creditor's claim is secured.

The first sentence does ***not*** indicate ***how*** that value is to be determined. As Collier explains, § 506(a)'s first sentence deals with "several factors ***other than the methodology and basis of valuation.***" 3 Collier On Bankruptcy, ¶ 506.04[1] at 506-17 (15th ed. 1990) (emphasis added).

Congress used the phrase "creditor's interest in the estate's interest in such property" to provide for the various circumstances in which the creditor has an interest in less than the full intrinsic value of the collateral. For example, the debtor may own less than an undivided fee interest in the collateral. *See* 3 Collier On Bankruptcy, *supra*, ¶ 506.04[1] at 506-17 – 506-18. Such limited estates are a common feature of real property ownership. The value of a creditor's interest in the collateral cannot exceed the value of the debtor's or the estate's interest in it.

Likewise, the creditor's lien may encumber less than the full value of the debtor's interest in the collateral. The creditor's lien may be junior or subordinate to other liens on the same property. In *In re Taffi*, 96 F.3d 1190, 1191 (9th Cir. 1996), for example, the IRS' lien was subordinate to $233,942 in senior liens. The value of the IRS' lien was not the full value of the collateral because the senior debt had to be paid before the IRS received any value from the collateral. The IRS' "interest in the collateral" had less value than the interest of the creditor holding the senior lien encumbering the same property.

This is the meaning of § 506(a)'s first sentence. That sentence's reference to "the value of such creditor's interest in the estate's interest in the collateral" serves to emphasize that neither the debtor nor the creditor may have rights in the collateral's full intrinsic value. The sentence directs the bankruptcy court to make appropriate deduction for such limitations in valuing the creditor's security.

Timbers confirms this interpretation of § 506(a)'s first sentence. Construing the similar wording of 11 U.S.C. § 362(d), the Court said, "The term 'interest in property' certainly summons up such concepts as 'fee ownership,' 'life estate,' 'co-ownership,' and 'security interest' more readily than it does the notion of 'right to immediate foreclosure.' " 484 U.S. at 371. Just so. If "the estate's interest in such property" is a life estate or co-ownership, § 506(a) directs the bankruptcy court to value that diminished interest in the collateral, not the collateral's full intrinsic value. Likewise, if the creditor holds a subordinate security interest, § 506(a)'s first sentence mandates that the subordinate interest be valued, not the full fee. That is the sole function of § 506(a)'s first sentence – to describe ***what*** must be valued.

2. The Creditor's Interest In The Collateral Is Not Limited To The Collateral's Value Upon Foreclosure Sale

The Fifth Circuit's en banc majority opinion wrongly ascribes an additional meaning to § 506(a)'s first sentence. It equates "creditor's interest" with the right to foreclose upon and sell the collateral and holds that valuation of the "creditor's interest" must "start[] with what the creditor could realize by repossession and sale of the collateral." Pet. App., 14a, 28a (fn. omitted).

This extra step is wrong as a matter of statutory construction and as a matter of non-bankruptcy law.

a. The Creditor's Interest In The Collateral Cannot Mean Just The Right To Foreclose And Sell The Collateral

In equating "creditor's interest in the property" with the right to foreclose upon and sell the collateral, the Fifth Circuit majority opinion attributes to the quoted phrase the one meaning which this Court ruled out in *Timbers*:

> In subsection (a) of this provision [§ 506(a)] ***the creditor's "interest in property" obviously means his security interest without taking account of his right to immediate possession of the collateral on default***. If the latter were included, the "value of such creditor's interest" would increase, and the proportions of the claim that are secured and unsecured would alter, as the stay continues – since the value of the entitlement to use the collateral from the date of bankruptcy would rise with the passage of time. No one suggests this was intended. ***The phrase "value of such creditor's interest" in § 506(a) means "the value of the collateral."*** [Citations.]

484 U.S. at 372, 108 S.Ct. at 631 (emphasis added).

As *Timbers* suggests, if Congress had intended to have the bankruptcy court value the creditor's "remedy" of foreclosure and sale, it would have used that term or some similar language, not the term "creditor's interest." "Creditor's interest" "summons up such concepts as 'fee ownership,' 'life estate,' 'co-ownership,' and 'security interest' more readily than it does the notion of 'right to immediate foreclosure.' " 484 U.S. at 371.

Furthermore, if the creditor's interest is equated with the right to foreclose and sell the collateral, § 506(a)'s second sentence is nullified. Under that reasoning, value is always determined by the foreclosure sale price of the collateral, no matter what the proposed disposition or use. *In re Winthrop Old Farm Nurseries, Inc.*, 50 F.3d 72, 76 (1st Cir. 1995); *In re Trimble*, 50 F.3d 350, 532 (8th Cir. 1995). Such an interpretation "violates the settled rule that a statute must, if possible, be construed in such fashion that every word has some operative effect." *United States v. Nordic Village, Inc.*, 503 U.S. 30, 112 S.Ct. 1011, 1015, 117 L.Ed.2d 181 (1992); *Hoffman v. Connecticut Dept. of Income Maintenance*, 492 U.S. 96, 103, 109 S.Ct. 2818, 2823-24, 106 L.Ed.2d 76 (1989).[3]

Attempting to accord § 506(a)'s second sentence *some* meaning, the Fifth Circuit majority suggested that the debtor's proposed use of the collateral can affect valuation of the creditor's interest in those instances in which the "'the debtor's use of the collateral may be particularly beneficial, or particularly detrimental, to its value. For example, the collateral may consist of equipment which is being used by the debtor twenty-four hours per day, so

[3] The general principle that all statutory words are to be given effect is especially applicable in this instance. Section 506(a)'s second sentence was added to the House Bill in the Senate, was mentioned in the Senate Report on the bill, and was retained by the conference committee. *Compare* H.R. 8200, 95th Cong. 1st Sess., § 506(a), p. 387 (1977) with S. 2266, 95th Cong., 2d Sess., § 506(a), p. 394 (1978); S. Rep. 95-595, 95th Cong., 2d Sess., 68 (1978); *see* 124 Cong. Rec. S 17411 (daily ed. Oct. 6, 1978). Plainly, Congress attached considerable significance to the addition of § 506(a)'s second sentence. The courts must do so as well.

that its use is causing rapid deterioration.'" Pet. App., 25a, quoting J. F. Queenan, *Standards for Valuation of Security Interests in Chapter 11*, 92 Com. L. J. 18, 37 (1987).

This effort to give *some* meaning to § 506(a)'s second sentence is fatally flawed. First, it still leaves § 506(a)'s second sentence only "trivial application" and should be rejected for that reason alone. *See United States v. Nordic Village, Inc., supra*, 112 S.Ct. at 1015. It is highly unlikely that the Senate would have added § 506(a)'s second sentence and that the conference committee would have retained that change for the sole purpose of dealing with the highly unusual situations of particularly beneficial or detrimental use by the debtor.

Second, this effort is at odds with the Fifth Circuit majority's basic theory that what is being valued is the creditor's right to foreclose and sell the collateral. The foreclosure sale price is not increased if the debtor puts the collateral to a "particularly beneficial" use. Foreclosure will remove the collateral from the debtor's hands and place the collateral in others' hands. Their less beneficial use of the collateral will determine its foreclosure sale price.

Similarly, a debtor's "particularly detrimental" use of the collateral will not affect the foreclosure sale price because foreclosure will end that use.[4] If the debtor's

[4] The Fifth Circuit majority did not explain how the value of the creditor's interest would be affected by a "particularly detrimental" use. Would the value decrease to reflect the higher rate of depreciation? Or would the value increase to reflect the creditor's greater risk? The Fifth Circuit majority's silence on this crucial point illustrates the logical inconsistency between its proposed meaning for § 506(a)'s second sentence and the meaning it wrongly ascribed to the section's first sentence.

detrimental use increases depreciation of the collateral's value, the bankruptcy court should order repayment of the collateral's value over a commensurably shorter period or perhaps augment the adequate protection given the creditor instead of relief from the automatic stay, see Pet. App., 27a, but the value should not change as a result.

b. Under Non-Bankruptcy Law, The Creditor's Interest In The Collateral Includes More Than The Right To Foreclose And Sell The Collateral

As a matter of non-bankruptcy law, it is also incorrect to equate a creditor's security interest solely with the right to foreclose and sell. As with fee ownership, *see Andrus v. Allard*, 444 U.S. 51, 66, 100 S.Ct. 318, 327, 62 L.Ed.2d 210 (1979), a security interest involves a bundle of rights, only one of which is the right to foreclose and sell. *See also Nobleman v. American Savings Bank, supra*, 113 S.Ct. at 2110 (secured creditor's "rights" include more than right to foreclose). *In re Green*, 151 B.R. 501, 505 (Bankr. D. Minn. 1993) recognized this fact:

> [A] lien is fundamentally a *security* interest which secures payment of an obligation. To value such an interest in property based solely on the amount that could be realized upon sale of the collateral ignores the value associated

with the right to receive the stream of payments that the lien secures.

Another stick in the secured creditor's bundle of rights is the right to repossess the personal property collateral and retain it in satisfaction of the debt.[5] Tex. Bus. & Comm. Code Ann., § 9.505; *Tannenbaum v. Economics Laboratory, Inc.*, 628 S.W.2d 769, 771 (Tex. 1982). If the collateral is real property, the creditor may credit bid at the foreclosure sale, and thus receive full title to the property in satisfaction of the debt. By these means, the creditor may, if it so chooses, obtain for itself the full retail or fair market value of the collateral either for its own use or for resale at retail prices.

Yet another stick in the secured creditor's bundle is the right to share in any appreciation of the collateral. *Dewsnup v. Timm*, 502 U.S. 410, 417, 112 S.Ct. 773, 778, 116 L.Ed.2d 903 (1992).

In many cases, the secured creditor chooses to foreclose and sell, obtaining a lower price, but quickly converting its security interest into money that can be reinvested more profitably elsewhere. But that is the

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[5] The Fifth Circuit majority opinion suggests no rational means of valuing collateral when the creditor makes a practice of retaining collateral in satisfaction of the debt. Is the collateral to be valued at the full amount of the debt discharged when the creditor retains the collateral? Is the collateral to be valued at retail because the creditor may obtain retail prices on resale or may itself make a retail use of the collateral? Or is wholesale value to be applied even under these circumstances? The Fifth Circuit majority opinion and other cases following the same reasoning give no clue as to how the courts should solve this conundrum.

secured creditor's choice, not the limit or measure of its interest in the property.

It is simply not true that a creditor's interest in collateral equals only the right to foreclose and sell the property at foreclosure sale prices. Beyond misconstruing § 506(a), the Fifth Circuit majority opinion misinterprets the underlying non-bankruptcy law establishing secured creditors' rights in the collateral.

B. Section 506(a)'s Second Sentence States How The Creditor's Interest Is To Be Valued

Section 506(a)'s second sentence states ***how*** a court is to value the collateral and any lesser interests in that collateral owned by the estate and the creditor: "Such value shall be determined in light of the purpose of the valuation and the proposed disposition and use of such property. . . . "

Following this clear direction causes little problem once it is seen that what is to be valued is ***not*** the creditor's right to foreclose and sell the collateral but instead the collateral or the estate's or creditor's less-than-total interest in the collateral.

In the context of the present case, the "purpose" of the valuation is to determine the amount that the secured creditor must be paid under the debtors' Chapter 13 plan, not to determine the amount the creditor would receive if it hypothetically had to repossess and sell the collateral. *In re Trimble, supra*, 50 F.3d at 632. The proposed disposition and use of the collateral is retention by the debtor, not foreclosure and sale.

When the debtor intends to retain the collateral, the value of the creditor's interest in the estate's interest in that collateral must be ascertained in accordance with that planned use, and not according to what might hypothetically happen if the exact opposite – foreclosure and sale – occurred. Courts that have properly focused on § 506(a)'s second sentence have so held. *E.g., In re Taffi, supra,* 96 F.3d at 1192;[6] *In re Winthrop Old Farms Nurseries, Inc., supra,* 50 F.3d at 75; *In re Coker,* 973 F.2d 258, 260 (4th Cir. 1992); *In re Balbus,* 933 F.2d 246, 251 (4th Cir. 1991); *In re McClurkin,* 31 F.3d 401, 405 (6th Cir. 1994); *Lomas Mortgage USA v. Wiese,* 980 F.2d 1279, 1285 (9th Cir. 1992), *vacated on other grounds,* 113 S.Ct. 2925, 124 L.Ed.2d 676 (1993).

The value of collateral that a debtor retains under a plan is the value of the collateral to the debtor – the amount the debtor would pay on the open market for that or similar property. If the collateral is a house, its value to the debtor is the full fair market sales price of the house, without any deduction for selling costs. *In re Winthrop Old Farms Nurseries, Inc., supra,* 50 F.3d at 74; *In re McClurkin, supra,* 31 F.3d at 405; *Lomas Mortgage USA v. Weise, supra,* 980 F.2d at 1285-86; *In re Balbus, supra,* 933

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[6] "In this case, the key fact is that the debtors are going to possess the [collateral]. This fact determines the disposition and use of the creditor's interest. The foreclosure value is not relevant because no foreclosure is intended by the Plan. The [debtors] are in, not outside of, bankruptcy. The [creditor] is not foreclosing. Valuation must be accomplished within the actual situation presented. Consequently, the value has to be the fair market value of what the debtors are using." *In re Taffi, supra,* 96 F.3d at 1192.

F.2d at 252; *In re Case,* 115 B.R. 666, 669-70 (9th Cir. BAP 1990). That is the price the debtor would have to pay to buy, retain, and use the house outside of bankruptcy. That is the value that best reflects the debtor's intention to retain and use the property through the bankruptcy plan.

For the same reasons, if the collateral is a car, its value to a consumer debtor is the amount the debtor would have to pay to buy the car on the open market; generally speaking, its retail value. *In re Trimble, supra,* 50 F.3d at 532.

IV

PROPERLY INTERPRETED, SECTION 506(a) FULFILLS CONGRESS' INTENT TO ALLOW CREDITORS TO SHARE IN THE ENHANCED VALUE CREATED BY REORGANIZATION

The interpretation of § 506(a) suggested in the foregoing section of this brief not only harmonizes the section's two sentences, it also fulfills Congress' intent to permit creditors to share in the enhanced value created by reorganizations.

A. Congress Intended Creditors To Share The Enhanced Value Of Collateral Retained Under A Chapter 13 Plan

In enacting the Bankruptcy Reform Act of 1978 and the Bankruptcy Amendments and Judgeship Act of 1984, Congress intended to encourage consumer debtors to file under Chapter 13 rather than under Chapter 7. *See* H.R. Rep. 595, 95th Cong., 1st Sess. 118, 125 (1977) *reprinted in* 1978 U.S. Code Cong. & Admin. News 5963, 6079, 6086;

130 Cong. Rec. H7499 (daily ed. June 29, 1984) (remarks of Rep. Anderson); 130 Cong. Rec. S8894 (daily ed. June 29, 1984) (remarks of Sen. Hatch), *reprinted in* 1984 U.S. Code, Cong. & Admin. News 590, 598.

As Congress recognized, proceeding under Chapter 13, rather than Chapter 7, should benefit both debtors and creditors. Chapter 13 proceedings help debtors avoid the stigma of bankruptcy and any resulting blot on their credit standing. Fulfillment of a Chapter 13 plan allows the debtor "to retain the pride attendant on being able to meet one's obligations." H.R. Rep. 595, *supra*, at 118; 1978 U.S. Code, Cong. & Admin. News at 6079.

Chapter 13 also benefits the debtor by allowing the debtor to retain his or her assets which are normally worth more to the debtor and cost more to replace than the price at which they can be sold. H.R. Rep. 595, *supra*, at 124; 1978 U.S. Code, Cong. & Admin. News at 6085.

Chapter 13 was also intended to aid creditors: "The benefit to creditors is self-evident: Their losses will be significantly less than if their debtors opt for straight bankruptcy." H.R. Rep. 595, *supra*, at 118; 1978 U.S. Code, Cong. & Admin. News at 6079.

Implementing this Congressional intent, section 1325(a)(4) requires that Chapter 13 plans provide *unsecured* creditors "not less than the amount that would be paid on such claim if the estate of the debtor were liquidated under chapter 7 of this title. . . . " As the House Report states, Chapter 13 allows debtors to propose realistic payment plans, but "[c]reditors will not be disadvantaged, because the plan must still pay them more than

they would get under a liquidation." H.R. Rep. 595, *supra*, at 124; 1978 U.S. Code, Cong. & Admin. News at 6085.

Secured creditors must receive even better treatment than unsecured creditors under Chapter 13 plans;[7] hence, even better treatment than the secured creditor would receive under Chapter 7. Under Chapter 7, the secured creditor receives the collateral in kind or the net proceeds of its sale by the trustee, or the debtor keeps the collateral and reaffirms the debt. *See* 11 U.S.C. §§ 363, 524. Chapter 13 guarantees secured creditors more. Unless a secured creditor accepts the plan or the debtor surrenders the collateral, the plan must give the secured creditor a continuing lien in the collateral and provide for payment of an amount "not less than the allowed amount of such claim." 11 U.S.C. § 1325(a)(5)(B)(ii).

The allowed amount of the secured claim is determined under § 506(a), which directs that the value of the creditor's interest in the estate's interest in the collateral be determined in light of the purpose of the valuation and the proposed use or disposition of the property. The proposed use or disposition of the collateral under a Chapter 13 plan typically is retention by the debtor, a use which Congress recognized enhanced the value of the collateral – hence, benefited the debtor. By taking that value enhancement into account in setting the allowed

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[7] If secured creditors were not meant to receive better treatment under Chapter 13 plans than unsecured creditors, Congress would not have made separate provision for secured creditors in section 1325, but would have simply provided that all creditors should receive no less than they would upon liquidation under Chapter 7.

amount of secured claims for purposes of Chapter 13 plans, Congress achieved the sharing of benefits from reorganization which it intended to establish.

B. The Sharing Of Enhanced Value Compensates Creditors For Additional Risks They Encounter Under Chapter 13 Plans

Sharing the enhanced value generated by reorganization, as Congress intended, compensates secured creditors for the additional risks they run in a Chapter 13 proceeding.

A Chapter 13 plan normally provides for the debtor to pay a secured creditor the value of its collateral over an extended period, typically three to five years. 11 U.S.C. § 1325(a)(5)(B)(ii). In the case of an undersecured creditor, the promised payments are already less than the amount of the original debt.

Like any promise, the debtor's promise to pay the collateral's value over a three-to-five-year period is worth less than cash in hand. Much less. After all, the debtor already defaulted once on his or her promises. The new promise is even less likely to be fulfilled.

As a group, Chapter 13 debtors are poor credit risks. Only about a third of Chapter 13 debtors complete their plans and receive a discharge.[8] The remaining two-thirds

[8] W.C. Whitford, The Ideal of Individualized Justice, 68 Am. Bankr. L.J. 397, 410-411 (1994); T. A. Sullivan, E. Warren & J. L. Westbrook, Consumer Debtors Ten Years Later: A Financial Comparison of Consumer Bankrupts 1981- 1991, 68 Am. Bankr.

of Chapter 13 cases are dismissed or converted into Chapter 7 liquidations.

Because of the high risk of plan failure and default, a debtor's promise to pay foreclosure value, even with interest, over the course of the plan is inherently of less value than what a secured creditor would receive through straight liquidation – either the property or its value immediately.

Deterioration or depreciation of the collateral while the debtor proceeds under a Chapter 13 plan poses an additional, serious risk for secured creditors. In the two-thirds of Chapter 13 proceedings that fail, the creditor eventually must resort to its collateral for payment of the remaining debt after dismissal or conversion of the Chapter 13 case.

Secured creditors commonly find that the property has deteriorated or depreciated during the course of the plan far beyond the amount of any payments the secured creditor has received under the plan.[9] The reason is apparent. Chapter 13 proceedings fail because debtors lack funds to pay creditors the amounts promised under

L.J. 121, 143, 145 (1994); Admin. Off. Of U.S. Cts., Annual Report of the Director, 1991, at 296, Table F-2 (1992); T. A. Sullivan, E. Warren & J. L. Westbrook, *As We Forgive Our Debtors*, 222 (1989); Admin. Off. Of U.S. Cts., Annual Report of the Director, 1981, at 544, Table 2FA (1982).

[9] "Adequate protection" payments under 11 U.S.C. §§ 361, 362(d)(1) typically are based on the assumption that the collateral will be subject to only ordinary depreciation. Hence, even when such payments are made, they frequently fail to compensate adequately for the usually more rapid depreciation of assets retained by the debtor.

their plans or lack the financial discipline to do so. The same lack of funds or financial discipline will commonly lead debtors to neglect or defer needed, but often costly, maintenance of the collateral.

Also, even though contractually obligated to insure the collateral, hard-pressed debtors are also likely to skimp on insurance premiums, often resulting in cancellation or non-renewal of their policies. Lack of insurance on the collateral exposes their secured creditors to risk of uninsured loss or damage to the collateral or to the expense of buying insurance for themselves. Thus, when the Chapter 13 plans fail, and the creditor forecloses, or receives the collateral upon conversion to Chapter 7, it usually finds it has suffered a substantial loss during the delay caused by the failed Chapter 13 proceeding.

Congress rationally chose to make debtors compensate secured creditors for these additional risks inherent in Chapter 13 proceedings. That compensation is the required sharing with secured creditors of the enhanced value of collateral which debtors retain under their plans. In so doing, Congress conferred no windfall on secured creditors. They recover no more than what they are owed in any case, and in most instances considerably less. Congress has merely chosen not to make them suffer more extensive losses.

By contrast, the debtor will receive an unwarranted windfall, if allowed to retain the entire enhanced, reorganization value of the collateral. *See Dewsnup v. Timm*, *supra*, 502 U.S. at 417, 112 S.Ct. at 778; *In re Taffi*, 68 F.3d 306, 308 (9th Cir. 1995), *aff'd en banc*, 96 F.3d 1190 (9th Cir. 1996).

For good reasons, Congress decided to allow secured creditors to participate in the enhanced value created by reorganization. Its decision, as embodied in § 506(a) must be given effect.

V

SPLITTING THE DIFFERENCE IS NOT AN ACCEPTABLE RULE OF DECISION

The alternative approaches to valuation recently adopted by the Second and Seventh Circuits should be rejected for many of the same reasons the Court should reverse the Fifth Circuit's majority.

A. The Seventh Circuit Wrongly Followed Game Theory Instead Of Congress' Directive

The Seventh Circuit's "split the difference" approach is founded on the premise that § 506(a) provides no meaningful guidance to courts in valuing the secured portion of an undersecured creditor's claim. *In re Hoskins*, *supra*, 102 F.3d at 314. As Judge Posner bluntly stated: "We get little help from the statute." *Ibid.*

Having cut itself loose from statutory guidance, the Seventh Circuit turned to economics and game theory to characterize the secured creditor's and the debtor's bargaining positions as a "bilateral monopoly" in which both parties are best off striking a bargain somewhere between liquidation value and replacement cost. *Id.*, at 315. Finally, the Seventh Circuit said that there is no way to predict where within that range an actual bargain would be struck, but that the midpoint – splitting the difference

– was a focal point to which parties would gravitate to avoid transaction costs. *Id.*, at 316.

The *Hoskins* opinion is, no doubt, ingenious, but it is flawed at the outset by its incorrect premise that § 506(a) provides "little help" in determining the value of the secured portion of an undersecured creditor's claim. As already explained, § 506(a) gives the needed guidance. The section's second sentence was added by the Senate and accepted by the House for the very purpose of providing the direction which the Seventh Circuit erroneously finds lacking.

Congress has decreed a method for ascertaining the value of the secured portion of the undersecured creditor's claim. It is pointless to speculate how the parties might bargain to reach a value in the absence of that statutory directive. Furthermore, bargaining position does not determine the value of a claim in bankruptcy. *Case v. Los Angeles Lumber Products Co.*, 308 U.S. 106, 129-31, 60 S.Ct. 1, 14, 84 L.Ed. 110 (1939).

B. The Second Circuit Incorrectly Abandons The Rule Of Law For Standardless Judicial Discretion

The Second Circuit's recent decision in *In re Valenti*, *supra*, 1997 WL 31577, begins at roughly the same place as the Seventh Circuit and arrives at about the same result but by a totally different and equally inappropriate route.

Like *Hoskins*, *Valenti* begins with the proposition that § 506(a) is not helpful, failing to specify how courts should value the secured portion of an undersecured

creditor's claim. 1997 WL 31577 at 4. *Valenti* posits a conflict between the section's first sentence, which *Valenti* sees as pointing toward foreclosure value, and the section's second sentence, which *Valenti* views as suggesting replacement cost as the valuation standard for collateral retained by the debtor. *Id.* at 5.

Finding no resolution of the issue in the statute's terms, the Second Circuit, unlike the Seventh, decided not to impose a rule of its own making, believing "the correct result is that no fixed value, whether it be retail, wholesale, or some combination of the two, should be imposed on every bankruptcy court conducting a § 506(a) valuation." *Id.* at 6. Under the Second Circuit's approach each bankruptcy judge is free to decide for him- or her-self how to value retained collateral so long as he or she "considers" both the purpose of the valuation and the proposed use or disposition of the collateral. *Ibid.*

This approach is just as flawed as the Seventh Circuit's. Like *Hoskins*, *Valenti* begins by denying that Congress has said anything coherent on the subject. Instead of attempting to reconcile § 506(a)'s two sentences, *Valenti* presumes that Congress meant them to conflict with each other, leaving the courts with no useful guidance on the issue of valuing the unsecured portion of an undersecured creditor's claim. In doing so, *Valenti* violates a cardinal rule of statutory construction. *Federal Power Comm'n v. Panhandle E. Pipe Line Co.*, 337 U.S. 498, 514, 69 S.Ct. 1251, 1269, 93 L.Ed. 1499 (1949) ("If possible all sections of the Act must be reconciled so as to produce a symmetrical whole.")

Moreover, as the Seventh Circuit said in rejecting a similar *ad hoc* approach to valuation:

> [I]t is one thing to say that a uniform standard of valuation must be applied case by case, since application depends on the facts and they are different from case to case. It is another thing to say that there is no standard. Although there is some support in the legislative history for such an approach [citations], it would be peculiarly inappropriate to the valuation of Chapter 13 property. These are tiny cases. The debtor usually has few assets. To prevent the costs of bankruptcy litigation from eating up the entire debtor's estate, a simple rule of valuation is needed.

In re Hoskins, supra, 102 F.2d at 314.

In fact, the bankruptcy courts in the Second Circuit have already recognized the inappropriateness of the standard-less approach advocated in *Valenti* and have adopted their own standard by local rule, splitting the difference between wholesale and retail values except in unusual cases. *See In re Valenti, supra,* 1997 WL 31577 at 6. Thus, the net result of the Second Circuit's approach is to push down to an even lower and less appropriate level of the judiciary a decision regarding general rules and standards that should instead be, and were, adopted by the legislative branch. *See United States v. Noland,* ___ U.S. ___, 116 S.Ct. 1524, 1527-28, 134 L.Ed.2d 748 (1996).

Neither the Second Circuit nor the Seventh Circuit has paid proper deference to Congress' directive in § 506(a). Neither *Hoskins* nor *Valenti* adopts a proper interpretation of that section or a correct approach to

valuing collateral retained by a debtor under a Chapter 13 plan.

VI

CONCLUSION

For the reasons stated above, the Court should hold that a secured creditor, whose collateral is retained by the debtor under a Chapter 13 plan, has a secured claim to the extent of the fair market value of the collateral in the market in which the debtor would otherwise buy property of the same type to replace the collateral. This value must be reduced if the estate's or the creditor's interest in the collateral is limited.

Respectfully submitted,

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(12)

No. 96-454

IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1996

ASSOCIATES COMMERCIAL CORPORATION,
Petitioner,
v.

ELRAY RASH AND JEAN RASH,
Respondents.

On Writ of Certiorari
to the United States Court of Appeals
for the Fifth Circuit

BRIEF OF WASHINGTON LEGAL FOUNDATION AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER

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35 PP

QUESTION PRESENTED

Whether, when a debtor elects to retain a secured creditor's collateral under the cramdown powers of Chapter 13 of the Bankruptcy Code, the amount required to be paid for the creditor's secured claim is limited to the value that the secured creditor could have obtained if it had sold the collateral at foreclosure.

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11 U.S.C. § 1325(b)(1)(B) 21

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MISCELLANEOUS

Chaim J. Fortgang and Thomas M. Mayer, *Valuation in Bankruptcy*, 32 UCLA L. Rev. 1061 (1985) 5

David Gray Carlson, *Secured Creditors and the Eely Character of Bankruptcy Valuations*, 41 Am. U. L. Rev. 63 (1991) 6, 9, 10

David Gray Carlson, *Undersecured Claims Under Bankruptcy Code Sections 506(a) and 1111(b): Second Looks at Judicial Valuations of Collateral*, 6 Bankr. Dev. J. 253 (1989) 21

Thomas H. Jackson and Robert E. Scott, *Symposium on the Law and Economics of Bargaining: On the Nature of Bankruptcy: An Essay on Bankruptcy Sharing and the Creditors' Bargain*, 75 Va. L. Rev. 155 (1989) 20

The Cram Down and Valuation Under Chapter 11 of the Bankruptcy Code, 58 N.C. L. Rev. 925 (1980) . 25, 26

No. 96-454

IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1996

ASSOCIATES COMMERCIAL CORPORATION,
Petitioner,

v.

ELRAY RASH AND JEAN RASH,
Respondents.

On Writ of Certiorari
to the United States Court of Appeals
for the Fifth Circuit

BRIEF OF WASHINGTON LEGAL FOUNDATION
AS *AMICUS CURIAE*
IN SUPPORT OF PETITIONER

INTEREST OF THE AMICUS CURIAE

The Washington Legal Foundation ("WLF") is a non-profit public interest law and policy center based in Washington, D.C., with thousands of supporters nationwide. WLF regularly appears before federal and state courts promoting economic liberty, free enterprise principles, and a limited and accountable government. WLF's Legal Studies Division also publishes monographs and other publications on these topics.

WLF has appeared as *amicus curiae* in numerous cases before this Court involving issues of public importance,

including other bankruptcy cases. *See, e.g., Pennsylvania Dept. of Public Welfare v. Davenport*, 495 U.S. 552 (1990).

WLF believes that the decision below, which is contrary to the decisions of every other court that has considered the issues involved, represents a dramatic departure from property statutory interpretation. WLF believes that the U.S. Bankruptcy Courts should adhere to a conservative and restrained approach when interpreting statutes, should closely follow the "plain meaning" of statutes, and should eschew overly broad policy pronouncements and excessive economic analysis on the purported consequences of such statutes. WLF believes that this judicial restraint will avoid inconsistent decisions and avoid the polarization of bankruptcy law which has occurred throughout the United States.

STATEMENT OF THE CASE

Washington Legal Foundation adopts the Statement of the Case of the Petitioner.

SUMMARY OF ARGUMENT

The Fifth Circuit, in contrast to every other circuit that has considered the issue, decided in *Associates Commercial Corporation v. Rash (In re Rash)*, 90 F.3d 1036 (5th Cir. 1996), that when a Chapter 13 debtor elects to retain a secured creditor's collateral, the amount the debtor is required to pay for the creditor's secured claim is limited to the value that the secured creditor could have obtained if it had sold the collateral at foreclosure.

Washington Legal Foundation ("WLF") seeks reversal of *Rash* because this reading of 11 U.S.C. § 506(a) is inconsistent with the plain language of § 506(a). As the dissent in *Rash* states, the decision in *Rash* "dismantles 11 U.S.C. § 506(a)," and substitutes "judicial redrafting" for principled rules of statutory interpretation. *Rash*, 90 F.3d at 1061 (Smith, J., dissenting). The decision in *Rash* invites a level of judicial activism in a crucial area of bankruptcy law (valuation), an area in which Congress has, indeed, spoken with a "plain" voice.

Because the statute is clear, there is no need to examine the statute's legislative history. Nonetheless, the legislative history also supports reversal of the Fifth Circuit's decision because it directs that courts should determine value in light of the purpose of the valuation and the proposed disposition or use of the collateral. Moreover, the Fifth Circuit improperly applied an erroneous economic analysis -- one that improperly placed the interests of debtors over the legitimate interests of secured creditors -- in its misguided attempt to demonstrate that Congress could not have intended the outcome mandated by the plain meaning of section 506(a).

Finally, WLF seeks reversal because this case has potentially serious consequences in its application to business reorganizations under Chapter 11. Indeed, because Chapter 5 of the Bankruptcy Code, in which Section 506(a) is found, applies generally to the operative bankruptcy chapters (Chapters 7, 11, 12 and 13), *Rash's* consequences extend beyond Chapter 13. Accordingly, this case applies not only to trucks retained by consumer debtors, but also to collateral retained by Chapter 11 business debtors and to determinations of adequate protection and confirmations of

"cramdown" plans in Chapter 11 cases. The decision in *Rash* constitutes an unwarranted judicial intrusion into the marketplace and endangers the fair balance between the rights of debtors and creditors.

The goals of predictability, judicial conservatism, and an appropriate balancing of debtor/creditor interests were all injured in *Rash*. Your amicus joins with numerous others in urging this Court to reverse the Fifth Circuit's decision in *Rash*.

ARGUMENT

1. THE FIFTH CIRCUIT ERRED IN ITS INTERPRETATION OF SECTION 506(a) AND DISREGARDED THE PLAIN MEANING OF SECTION 506(a)

A. The Fifth Circuit Erroneously Focused on the First Sentence of Section 506(a) and Thereby Ignored the Plain Meaning of Section 506(a)

The question presented to the Fifth Circuit was a narrow one: What is the appropriate method to value collateral that a Chapter 13 debtor proposes to retain in conjunction with a plan of reorganization? The Bankruptcy Code provision governing valuations of collateral is 11 U.S.C. § 506(a), and it provides as follows:

> An allowed claim of a creditor secured by a lien on property in which the estate has an interest, or that is subject to setoff under section 553 of this title, is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property, or to the extent of the amount subject to setoff, as the case may be, and is an unsecured claim to the extent that the value of such creditor's interest or the amount so subject to setoff is less than the amount of such allowed claim. Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor's interest.

The Fifth Circuit in *Rash* was confronted with a seemingly straightforward, but crucial distinction in methods of valuation; should it utilize the "replacement" or "retail" method of valuation,[1] as urged by the petitioner Associates Commercial Corporation ("ACC"), or should it utilize a foreclosure or "wholesale" model for valuation purpose under § 506(a). This choice between liquidation value and retail value "lies at the heart of most disputes over asset valuation in bankruptcy." Chaim J. Fortgang and Thomas M. Mayer, *Valuation in Bankruptcy*, 32 UCLA L. Rev. 1061, 1063 (1985).

Generally, "[i]f an asset is not used as part of a business, or if the business is not viable, the asset is valued at how much it will bring at a sale less the costs of

[1] The term "replacement costs" does not mean what it costs the Rashes to buy a truck of the same make and model, but rather "the costs to the Rashes of purchasing a hypothetical truck that is identical in all respects -- age, milage and operating conditions -- to the Rashes' truck." *Rash*, 90 F.3d at 1041 n.3. This is known as the "retail" or "replacement cost" method of valuation. *See id.* at 1062 n.1 (Smith, J., dissenting).

disposition -- a liquidation value."[2] Conversely, a "going concern" is a business with some sort of future and requires the use of retail value.[3] The difference in monetary terms between the two is that generally "replacement cost equals an asset's retail price, and foreclosure value equals its wholesale price, which is equivalent to retail price less hypothetical costs of sale." *Rash*, 90 F.3d at 1062 n.1 (Smith, J., dissenting).[4]

The starting point for the analysis of § 506(a) is the statute's "plain meaning." *United States v. Ron Pair Enter., Inc.*, 489 U.S. 235, 240 (1989). "[F]or where, as here, the statute's language is plain, 'the sole function of the courts is to enforce it according to its terms.'" *Id.* The mere fact that opposing parties find contradictory meanings does not render a statute ambiguous, nor lacking in plain meaning.[5]

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[2] Fortgang and Mayer, *supra*, at 1064.

[3] *See* David Gray Carlson, *Secured Creditors and the Eely Character of Bankruptcy Valuations*, 41 Am. U. L. Rev. 63, 75-77 (1991). Professor Carlson writes, "[E]stimating the value of property is an art, not a science" and that while all of the various formulations suffer from a lack of content, "the choice for hypothesizing market exchanges is usually narrowed down to a choice of going concern value and liquidation value," a choice that confronts most bankruptcy courts. *Id.* at 75.

[4] But, as the dissenting judges in *Rash* pointed out, "the terms 'retail' and 'wholesale' value only loosely describe the replacement and foreclosure approaches." *Id.*

[5] The "plain meaning" that is sought here is not the kind of "pernicious oversimplification" that Justice O'Connor expressed concern over in her dissenting opinion in *Ron Pair* where she cited Justice (continued...)

As the dissent *Rash* stated, "Section 506(a) is not difficult to interpret." *Rash*, 90 F.3d at 1061 (Smith, J., dissenting).[6] The textual debate, to the extent one exists, has involved the relative significance of the first sentence, which focuses on the "creditor's interest" versus the second sentence which focuses on "use and disposition" in determining the property's value. Although there is an apparent "tension" between the two sentences, they can be readily and sensibly reconciled without rendering either sentence meaningless.[7]

As the dissent in *Rash* recognized, the phrase "creditor's interest in the estate's interest in" simply means that a creditor or debtor may have an interest in less than the full value of the collateral. *Rash*, 90 F.3d at 1064 (Smith, J., dissenting). The partial interest occurs where the creditor holds a partial lien on collateral or the debtor has a partial ownership interest in the collateral. *Id.* (Smith, J.,

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[5](...continued)
Frankfurter's observation, "The notion that because the words of a statute are plain, its meaning is also plain, is merely pernicious oversimplification." *Ron Pair*, 489 U.S. at 249 (O'Connor, J., dissenting) (quoting *United States v. Monia*, 317 U.S. 424, 431 (1943) (Frankfurter, J., dissenting)).

[6] Indeed, this is a case that perhaps warrants Justice Scalia's observation that it is difficult to imagine why such an issue should have yielded a circuit split. *See Union Bank v. Wolas*, 502 U.S. 151, 163 (Scalia, J., concurring).

[7] *See*, for example, *In re Claeys*, 81 B.R. 985, 990 (Bankr. D. N.D. 1987), in which the court stated that "[w]hether a valuation is made without regard for potential costs of liquidation depends, it seems, upon the emphasis given to the first and second sentences of Section 506(a)."

dissenting). However, where there is only one creditor and one debtor, the value of the secured claim equals the value of the underlying collateral. *See id.* at 1061, 1064 (Smith, J., dissenting) (citing *United Sav. Ass'n v. Timbers of Inwood Forest Assocs.*, 484 U.S. 365, 372 (1988)).

This Court has consistently construed the phrase "creditor's interest" to be "equal to the lesser of the amount of the lien or the value of the collateral." For example, in *United Savings Association v. Timbers of Inwood Forest Associates*, 484 U.S. 365 (1988), this Court concluded that the phrase "value of such creditor's interest" in § 506(a) means the value of the collateral. *Id.* at 372; *see also Nobelman v. American Sav. Bank*, 508 U.S. 324, 328-29 (1993) (suggesting the same); *United States v. Ron Pair Enter., Inc.*, 489 U.S. 235, 239 (1989) ("Subsection (a) of § 506 provides that a claim is secured only to the extent of the value of the property on which the lien is fixed ...."), *see also, Huntington Nat'l Bank v. Pees (In re McClurken)*, 31 F.3d 401, 404 (6th Cir. 1994).[8]

In *Timbers*, an undersecured creditor moved for relief from the automatic stay to foreclose on its collateral, consisting of an apartment project and the project's rental income. The creditor sought relief from stay on the ground

[8] Also, in a footnote in the *Ron Pair* decision, this Court stated the following: "Thus, a $100,000 claim, secured by a lien on property of a value of $60,000, is considered to be a secured claim to the extent of $60,000, and to be an unsecured claim for $40,000." *Ron Pair Enter.*, 489 U.S. at 239 n.3 (emphasis added). This statement in the Court's own *Ron Pair* decision reinforces the fundamental concept that the phrase "value of such creditor's interest" in Section 506(a) means the value of the collateral.

that its interest in the collateral was not adequately protected. The creditor contended that the right granted by 11 U.S.C. § 362(d)(1) to adequate protection of an "interest in property" entitled it to compensation for the delay caused by the automatic stay in foreclosing on the collateral.

This Court noted that the term "interest in property" certainly summons up such concepts as "fee ownership," "life estate," "co-ownership," and security interest . . . ." *Timbers*, 484 U.S. at 371. Then, in analyzing the same "interest in property" term found in section 506(a), this Court concluded that the term "value of such creditor's interest" simply means "the value of the collateral." *Id.* at 372. Because this finding in *Timbers* excluded from value such other economic components as compensation for lost opportunity costs or other interest payments, it necessarily held that ongoing value is the touchstone. Thus, *Timbers* is significant in construing the two sentences in § 506(a).

The second sentence of § 506(a) provides explicit direction on how to value the collateral. Congress mandated in the second sentence that valuation "shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property." 11 U.S.C. § 506(a). Thus, the statute by its very terms directss that the value of the collaterol be determined based on the debtor's use of the property.[9] If the debtor elects to retain and "use" the

[9] Section 506(a) in its text invites a case-by-case analysis of value. As one commentator notes, "Congressional history celebrates the fact that judges are to make the rules for valuation on a case-by-case basis." David Gray Carlson, *Secured Creditors and the Eely Character of Bankruptcy Valuations*, 41 Am. U. L. Rev. 63, 64 (1991) (footnote (continued...)

collaterol, the appropriate value is the replacements value. If the debtor, instead, elects to "dispose" of the property, the value is the liquidation value.

Numerous courts prior to *Rash* had little difficulty in reconciling the two sentences of § 506(a).[10] In *Wold v. Goldome Realty Corp. (In re Liberty Assocs.)*, 105 B.R. 798 (Bankr. E.D. Pa. 1989), the court reconciled the statute as follows:

> The first sentence requires that the court value the creditor's interest in the estate's interest in the secured property. Thus, the creditor's interest can be ascertained only after the estate's interest is ascertained. As the second sentence dictates, the estate's interest must be measured in light of the disposition and use of the property articulated in the debtor's plan (or, in a Chapter 7 case like *Mays*, in accordance with the debtor's expressed intended future use of the property). Therefore, if

[9](...continued)

omitted) [hereinafter Carlson, *Secured Creditors*]. Unfortunately, as Professor Carlson further observes, "bankruptcy courts have indeed gratified the wishes of Congress by producing an extremely diverse and contradictory set of valuation theories." *Id.*

[10] The court in *In re Landing Associates*, 122 B.R. 288 (Bankr. W.D. Tex. 1990), reached this result, holding that when the debtor intends to retain property, "it would be artificial to deduct costs that creditor will not incur, so that creditor's interest should be determined without consideration of hypothetical liquidation costs." *Id.* at 294; *see also* Carlson, *Secured Creditors*, *supra*, at 101 n.191 (citing numerous other bankruptcy court decisions reaching similar conclusions).

> the debtor plans to retain the property valued under § 506(a), we do not believe that it is proper to factor in hypothetical sales costs.

Id. at 804 (footnote omitted) (citing *In re Mays*, 85 B.R. 955, 964 (Bankr. E.D. Pa. 1988), *aff'd*, 1988 WL 81716, 1988 U.S. Dist. LEXIS 8427 (E.D. Pa. Aug. 1, 1988)); *see also Brown & Co. Securities Corp. v. Balbus (In re Balbus)*, 933 F.2d 246, 248-49 (4th Cir. 1991) (concluding that the first sentence of Section 506(a) merely replicates the second sentence).

In contrast to these well-reasoned decision, *Rash* reads the second sentence of § 506(a) out of the statute in violation of this Court's admonition to give effect in construing a statute to each word in the statute. *Reiter v. Sonotone Corp.*, 442 U.S. 330, 339 (1979); *see also Timbers*, 484 U.S. at 371-72 (stating that statutory construction is a "holistic endeavor"). In rendering the second sentence of § 506(a) as surplusage, *Rash* robs courts of the flexibility that Congress granted the courts when valuing collateral. *See Winthrop Old Farm Nurseries, Inc. v. New Bedford Institution for Sav. (In re Winthrop Old Farm Nurseries, Inc.)*, 50 F.3d 72, 75 (1st Cir. 1995). If *Rash* correctly interprets § 506(a), then a debtor's proposed use of collateral can never be relevant in valuing the collateral since the value will always be set at the liquidation or foreclosure sale value.

Applying liquidation value here ignores the fact that the purpose of valuing collateral in a reorganization is to determine value where the debtor retains and continues to use the collateral. Where the debtor proposes to retain the collateral, the value to the debtor is the collateral's

replacement cost, without deducting nonexistent transaction costs. In *In re Taffi*, 96 F.3d 1190 (9th Cir. 1996), which was decided after *Rash*, the Ninth Circuit stated:

> When a Chapter 11 debtor or a Chapter 13 debtor intends to retain property subject to a lien, the purpose of a valuation under section 506(a) is not to determine the amount the creditor would receive if it hypothetically had to foreclose and sell the collateral. Neither the foreclosure value nor the costs of repossession are to be considered because no foreclosure is intended. Instead, when the proposed use of the property is continued retention by the debtor, the purpose of the valuation is to determine how much the creditor will receive for the debtor's continued possession. Hypothetical sales costs are not to be considered because no sale is intended.

Id. at 1192. The Ninth Circuit's decision in *Taffi* is brief and concise, finding nothing complex nor troublesome about the text of § 506(a).

The First Circuit reached the same conclusion in *Winthrop Old Farm Nurseries, Inc. v. New Bedford Inst. for Sav. (In re Winthrop Old Farm Nurseries, Inc.)*, 50 F.3d 72 (1st Cir. 1995) in which it held that "a court remains faithful to the dictates of section 506(a) by valuing the creditor's interest in the collateral in light of the proposed post-bankruptcy reality: no foreclosure sale and economic benefit for the debtor derived from the collateral equal to or greater than its fair market value." *Id.* at 75.

Where the debtor elects to retain the collateral, there is no foreclosure. Because the debtor, not the creditor, controls the decision whether to retain or dispose of the collateral, the debtor is given the right to determine how to maximize value. Thus, by proposing to retain and use the collateral, the debtor exercises this choice and acknowledges that the collateral has greater value than if the collateral is liquidated. *See Metrobank v. Trimble (In re Trimble)*, 50 F.3d 530, 531 (8th Cir. 1995).[11]

Only the Fifth Circuit has held that where the debtor proposes to retain collateral, that value is determined by what a creditor would receive in a hypothetical, non-existent, foreclosure sale. The plain meaning of the statute does not require any judicial policy making to find a "truer meaning." The temptation to tamper with the Bankruptcy Code for economic policy reasons (discussed below) should be eschewed. As the dissent in *Rash* states:

> The majority dismantles 11 U.S.C. § 506(a) by combining a question-begging interpretation of the statute's first sentence with an unreasonably restrictive reading of the second. Having thereby obscured the section's plain meaning, the majority turns to an inapposite presumption, an incorrect

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[11] The Fourth and Sixth Circuits have reached the same result. *See Huntington Nat'l Bank v. Pees (In re McClurkin)*, 31 F.3d 401, 405 (6th Cir. 1994) ("We ... hold that, where the debtor proposes to retain the collateral under a reorganization plan, § 506(a) does not require or permit a reduction in the creditor's secured claim to account for purely hypothetical costs of sale."); *Coker v. Sovran Equity Mortgage Corp. (In re Coker)*, 973 F.2d 258, 260 (4th Cir. 1992) (stating that hypothetical costs of sale may not be deducted when a debtor retains collateral).

> economic analysis, and the last resort of judicial redrafting-- selective reading of the legislative history. Not surprisingly, this policy-driven reconstruction of the statute has been squarely rejected by every other circuit that has considered it.

Rash, 90 F.3d at 1061 (Smith, J., dissenting).

The dissent highlights *Rash's* consequences. *Rash* violates the Court's continued efforts to respect and confine itself to the plain language of a statute -- not only as a means of determining Congress' intent, but more broadly in assuring integrity in the respective roles of the courts as they review and interpret statutes.[12]

B. While this Court Need Not Examine the Legislative History, the Legislative History Supports the View that Value Should be Predicated on Use and Disposition, Not On a Hypothetical Liquidation.

Because § 506(a) yields a plain and sensible meaning, this Court need not examine the legislative history to ascertain the intent of Congress. *Toibb v. Radloff*, 501 U.S. 157, 162 (1991) (stating that legislative history may be considered to resolve statutory ambiguity); *Ron Pair Enter., Inc.*, 489 U.S. at 240 ("[A]s long as the statutory scheme is

[12] The deviation in *Rash* from uniformly accepted plain meaning and the Fifth Circuit's explicit willingness to add policy overlays, calls to mind Justice Scalia's observation in his concurrence in *Patterson v. Shumate*, 504 U.S. 753, 766 (1992), that where courts depart from attention to text, there is a risk that we will no longer be able to fairly think of ourselves as a government of laws, rather than of men.

coherent and consistent, there generally is no need for a court to inquire beyond the plain language of the statute."). Nevertheless, should this Court examine the legislative history, the history supports the conclusion that value is to be determined by the collateral's use and disposition.

The legislative history to § 506(a) provides in pertinent part as follows:

> While courts will have to determine value on a case-by-case basis, the subsection makes it clear that valuation is to be determined in light of the purpose of the valuation and the proposed disposition and use of the subject property. This determination shall be made in conjunction with any hearing on such disposition or use of property or on a plan affecting the creditor's interest. To illustrate, a valuation early in the case in a proceeding under sections 361-363 would not be binding upon the debtor or creditor at the time of confirmation of the plan.

S. Rep. No. 989, 95th Cong., 2d Sess. 68 (1978), reprinted in 1978 U.S.C.A.A.N. 5787, 5854. This passage reinforces the fact that the courts should conduct valuations on a case-by-case basis in light of the "purpose of the valuation" and the proposed "disposition or use" of the collateral. It is nonsense, then, for the Fifth Circuit to suggest that Congress intended the courts to use a liquidation or foreclosure value in all cases and under all circumstances, regardless whether the liened property is to be sold, or retained and used by the debtor.

The legislative history relied upon by the Fifth Circuit in *Rash* did not deal directly with § 506(a), unlike the passage above, but rather addressed other provisions of the Bankruptcy Code that hardly offer guidance as to how a § 506(a) valuation should be conducted. For example, the Fifth Circuit looked to portions of the House report dealing with 11 U.S.C. § 722, the Bankruptcy Code provision authorizing debtors to redeem liened property from secured creditors. *Rash*, 90 F.3d at 1057. The Fifth Circuit quoted the passage in the House report, stating that § 722 is intended to allow debtors "to retain "necessary property" and "avoid high replacement costs," and surmised from there that the courts should not use a replacement cost or "retail" value under § 506(a). *Id.* (quoting H.R. Rep. No. 595, 95th Cong., 1st Sess. 127 (1977), reprinted in 1978 U.S.C.C.A.N. 5787, 6088).

But as the dissenting judges pointed out in *Rash*, a redemption under § 722 is essentially a liquidation sale of the property from the secured creditor to the debtor. The debtor is not holding and using property over time, as the debtor would in a Chapter 13 reorganization, while slowly paying the creditor in regular installments. Additionally, the legislative history's reference for "avoid[ing] high replacement costs" is not a mandate for using a liquidation or foreclosure value. Indeed, the replacement value method is wholly consistent with avoiding such high costs. The replacement method of valuation simply provides that

> a creditor cannot demand the collateral's original purchase price -- only its replacement cost in its current condition. To borrow the House report's illustration, the replacement approach does not permit [the creditor] to demand the $2000 that the

> debtor paid for new silverware and china; instead, he can demand only the $200 that the debtor would have to pay for a used set. The replacement approach means only that we cannot further deduct the hypothetical cost of selling the used goods.

Rash, 90 F.3d at 1070 (Smith, J., dissenting).

Also misplaced is the Fifth Circuit's emphasis on a passage of the House report, indicating that Congress enacted Chapter 13 in 1978 to curb "extraneous and non-financial pressures imposed by secured creditors" that allegedly enable them to recover more from the debtor than the property is worth. *See id.* at 1056 (citing H.R. Rep. No. 595, 95th Cong., 1st Sess. 124 (1977), reprinted in 1978 U.S.C.C.A.N. 5787, 6085). But the reforms enacted under Chapter 13 were designed to prevent secured creditors from refusing to participate in Chapter 13 plans. Under the old law, "[n]o matter how little the collateral was worth, a secured creditor could demand repayment of the original purchase price or refuse to participate in the plan," thereby gaining undue leverage over debtors. *Id.* at 1070 (Smith, J., dissenting).

Under the reformed Chapter 13 that was enacted with the 1978 Bankruptcy Code (and still in effect), debtors can force secured creditors to participate in their reorganizations. The one "reform" or "change" mentioned in the legislative history is that the courts are to "value the secured creditor's interest" -- a restatement of section 506(a), and accordingly, a rather unremarkable proposition. *See Rash*, 90 F.3d at 1056 (quoting H.R. Rep. No. 595, 95th Cong., 1st Sess. 124 (1977), reprinted in 1978 U.S.C.C.A.N. 5787 6085).

What this emphasis on high replacement costs means is that, in cramdown situations where the debtor is proposing to retain and use the property, the court should measure the current value of the collateral, and not adopt the original purchase price. *See id.* at 1071 (Smith, J., dissenting). The passage quoted by the Fifth Circuit majority does not mean that courts can reduce the value of the collateral by deducting hypothetical liquidation costs, when the debtor is proposing to keep the property, and therefore no liquidation or foreclosure is taking place.

C. The Fifth Circuit Improperly Applied an Erroneous Economic Analysis to Demonstrate That Congress Could Not Have Intended the Outcome Suggested by the Plain Meaning of Section 506

It is axiomatic that "[t]he plain meaning of legislation should be conclusive, except in the 'rare cases [in which] the literal application of a statute will produce a result demonstrably at odds with the intentions of its drafters.'" *Ron Pair Enter., Inc.*, 489 U.S. at 242 (quoting *Griffin v. Oceanic Contractors, Inc.*, 458 U.S. 564, 571 (1982)). Perhaps with this principle in mind, the Fifth Circuit in *Rash* sought to demonstrate that its interpretation of the "plain meaning" of § 506(a) resulted in the outcome that Congress intended. *Rash*, 90 F.3d at 1071 (citing *Ron Pair*, 489 U.S. at 242-23). The Fifth Circuit should not have conducted this analysis and, in any event, the analysis it conducted is simply wrong.

The Fifth Circuit's economic theories are neither analytically sound nor methodologically appropriate. Circuit Judge Smith correctly cautioned that an excessive attempt by courts to divine and apply correct economic consequence

interpretation as a methodology of statutory interpretation may lead to "judicial tampering." *Id.* at 1071. The reference to external economic theory leads to a lack of a coherent methodology.

Assuming *arguendo* that economic analysis is warranted in order to divine Congress's intent, the court's analysis in *Rash* contains two key fallacies. *Rash* erroneously states that valuing collateral at retail (1) does not create the potential for debtors to reap a windfall, and (2) amounts to a bonus for secured creditors. In fact, valuing collateral at wholesale amounts to a bonus for both unsecured creditors and debtors and creates the potential for debtors to reap windfalls.

Rash effectively reduces the secured creditor's claim to the collateral's liquidation value that the creditor could obtain through foreclosure and strips the secured creditor of the value to which it is entitled on account of the debtor's retention of the collateral. As a result, *Rash* impermissibly engages in redistributing value from secured creditors to debtors and unsecured creditors[13] This shifting of wealth violates the longstanding bankruptcy policy of preventing a party from receiving "a windfall merely by reason of the happenstance of bankruptcy." *Butner v. United States*, 440

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[13] *See* Thomas H. Jackson and Robert E. Scott, *Symposium on the Law and Economics of Bargaining: On the Nature of Bankruptcy: An Essay on Bankruptcy Sharing and the Creditors' Bargain*, 75 Va. L. Rev. 155, 155-56 (1989), in which the authors state that "[t]he cornerstone of the creditors' bargain is the normative claim that prebankruptcy entitlements should be impaired in bankruptcy only when necessary to maximize net asset distributions to the creditors as a group and never to accomplish purely distributional goals."

U.S. 48, 55 (1979). Outside bankruptcy, if the debtor retains and uses the collateral, the secured creditor is entitled to receive the agreed-upon payments from the debtor (which is usually more than the liquidation value).

In the long run, secured and unsecured lenders may change their lending requirements or interest rates to compensate for the value transfer that *Rash* imposes. As the dissent in *Rash* stated:

> The choice between the foreclosure and replacement approaches does favor either secured or unsecured creditors vis-a-vis the other, however. The foreclosure approach benefits unsecured creditors by reducing the value of secured claims, thereby freeing up more money for unsecured claims; the replacement approach does the opposite. Both types of creditors can largely compensate for either result by adjusting their interest rates or other lending practices, such as down payment requirements, accordingly. As a result, adoption of either rule will produce counterbalancing effects on the interest rates charged by secured and unsecured creditors, resulting in little net effect on consumers.

Id. at 1064 (citation omitted). Nonetheless, § 506(a) does not invite courts to transfer value from secured to unsecured creditors.

Neither does § 506(a) invite courts to transfer value from secured creditors to debtors. Yet the *Rash* decision issues such an invitation, and, in Chapter 13 cases, will result in a windfall for debtors. The Bankruptcy Code only

requires that Chapter 13 debtors pay projected disposable income to unsecured creditors for a three year period. 11 U.S.C. § 1325(b)(1)(B). Debtors will benefit from *Rash* by reducing obligations owed secured creditors whose payments can exceed the three year period and whose obligations must be repaid with interest, and leave debtors liable only to pay unsecured creditors for three years without interest. *Rash's* economic analysis constitutes an unwarranted intrusion by courts into the market place.

The majority in *Rash* mistakenly rejected ACC's contention that applying liquidation value creates the potential for debtors to reap a windfall. Indeed, *Rash* increases the risk of "debtor-arbitrage." Wholesale collateral valuations will enable "debtor arbitrage" by which debtors can resell assets at higher prices, thereby capturing the equity for themselves. *See* David Gray Carlson, *Undersecured Claims Under Bankruptcy Code Sections 506(a) and 1111(b): Second Looks at Judicial Valuations of Collateral*, 6 Bankr. Dev. J. 253, 266-67 (1989). As Professor Carlson stated, "The ability of a debtor to arbitrage between low bankruptcy court valuations and real market prices has been confirmed by two court of appeals decisions." *Id.* at 266.

Similarly, *Rash* will result in a transfer of value from secured creditors to debtors in Chapter 11 cases. One hallmark of the Bankruptcy Code's framework is that it fosters negotiated settlements especially in Chapter 11 cases. By stripping secured creditors of collateral value, *Rash* will result in additional value for debtors and unsecured creditors to divide in Chapter 11 cases.

None of the economic theorizing of the Fifth Circuit was warranted; the plain meaning of section 506 was and is sufficient. The Fifth Circuit should have avoided this foray into the murkier waters of economic modeling and forecasting.

II. *RASH* TREATS SECURED LENDERS IN CHAPTER 11 CASES UNFAIRLY AND WILL INJURE WELL-DEVELOPED NOTIONS OF ADEQUATE PROTECTION

A. The Use of Liquidation Value Under Section 506(a) is Inconsistent with the Theories of Adequate Protection and This Court's Ruling in *Timbers*

Although Chapter 5 of the Bankruptcy Code applies generally to the operative bankruptcy chapters (Chapters 7, 11, 12, and 13), the Fifth Circuit in *Rash* incorrectly concluded that its ruling will not affect cases filed under

Chapter 11.[14] In fact, the methodology implemented by the Fifth Circuit will apply far beyond the Chapter 13 context.

The Fifth Circuit's statement that its analysis does not apply to other chapters of the Bankruptcy Code fails. Indeed, this Court's analysis of § 506(a) will apply as much to the valuation of accounts receivable in Chapter 11, 12 and 13 cases as it will to vehicles in Chapter 13 cases. The underlying premise of the Fifth Circuit's ruling is that the "starting point" (as well as the ending point) under § 506(a) is what the creditor could realize if it sold the estate's interest in the property according to the security agreement.

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[14] The court in *Rash* incorrectly stated:

> Finally, our reference in *Timbers* to the benefits that inure to secured creditors from going-concern valuations must be placed in context. In Chapter 11 cases, a going-concern valuation of the reorganized debtor is a necessary step in applying the "fair andequitable" standard to a class of unsecured claims or a class of interests in a cram down under § 1129(b). It is not uncommon for a secured creditor to assert that the amount of its secured claim should be augmented by a portion of this going-concern value. Indeed, consensual plans under Chapter 11 sometimes, in effect, allocate some of this value to the secured claims. Whether the secured creditors are entitled to this value as a matter of law or equity is not at issue in this case and we express no opinion on it. <u>In any event, the Chapter 11 requirements mandating the going-concern valuations mentioned in Timbers do not have an analog in Chapter 13</u>.

Id. at 1053 n.23.

Rash, 90 F.3d at 1044. This premise is inconsistent with well-developed concepts of value that lie at the heart of Chapter 11 reorganizations and adversely impacts the well-defined case law regarding adequate protection.

Courts have consistently construed the value of property retained by Chapter 11 debtors to mean on-going value. A leading, early decision regarding adequate protection and its relationship to "lost opportunity costs" is *In re South Village, Inc.*, 25 B.R. 987 (Bankr. D. Utah 1982), which pre-dated yet anticipated much of this Court's analysis in *United Sav. Ass'n v. Timbers of Inwood Forest Assocs., Ltd.*, 484 U.S. 365 (1988). In *South Village*, the court reasoned that creditors could not recover both lost opportunity costs and ongoing value through adequate protection payments. Restated, since the premise of adequate protection mostly is predicated on "value" as being ongoing value, the creditor cannot seek payment for the loss of the ability to sell the collateral and re-invest the proceeds. *South Village*, 25 B.R. at 995.

South Village's analysis of "value," as in all bankruptcy analyses, begins with section 506(a), regardless whether the issue arises at a plan confirmation hearing in a Chapter 13 case or in connection with an award of adequate protection payments in a Chapter 11 case. *South Village* as well as the dissenting judges in *Rash* recognize that "[i]t is not the contract but the use which fixes the value...." *Id.* at 995 n.12. The analysis in *South Village* is in accord with the analysis in *Timbers* where this Court recognized that ongoing value, not liquidation value, governs determinations regarding adequate protection. This Court stated: "In subsection (a) of this provision the creditor's "interest in property" obviously means his security interest without

taking account of his right to immediate possession of the collateral on default." *Timbers*, 484 U.S. at 372.

If the Fifth Circuit's interpretation of § 506(a) is correct, then courts can apply liquidation values not only for plan confirmation purposes, but also for adequate protection purposes, thereby resurrecting the issue of entitlement to lost opportunity costs, which this Court resolved in *Timbers*.

B. The Use of Liquidation Value in Section 506(a) Will Lead to Cramdown Losses to Secured Creditors Under Section 1129(b)

Bankruptcy courts agree that going-concern value must be utilized in a Chapter 11 reorganization, unless the plan is specifically a liquidation plan. Judge Norton's admonition about fish and fowl in bankruptcy is perhaps the most colorful description of this concept. He stated:

> Having declared itself to be a fish to be reorganized, it would be inconsistent for the court now to permit the debtor to declare itself a fowl to be liquidated for purposes of "cramming down" a lower "appraisal" value upon the secured creditors. Therefore, a liquidation value, i.e., a foreclosure value, is a procedure totally foreign to this matter and not a proper standard for valuation.

In re Pine Gate Assocs., 12 C.B.C. 607, 624 (Bankr. N.D. Ga. 1977)).[15]

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[15] *See* Pachulski, *The Cram Down and Valuation Under Chapter 11 of the Bankruptcy Code*, 58 N.C. L. Rev. 925, 939 (1980)(stating that (continued...)

Section 1129(b) contains the "cramdown" provision of Chapter 11 which enables debtors to reduce their secured obligations to equal the value of the collateral which secures the obligations. The section provides that the holder of an allowed secured claim must receive "on account of such claim deferred cash payments totalling at least the allowed amount of such claim, of a value, as of the effective date of the plan, of at least the value of such holder's interest in the estate's interest in such property." 11 U.S.C. § 1129(b)(2)(A)(i)(II) (emphasis added). The phrase used for determining payments to be made to a secured creditor under a Chapter 11 plan is essentially the same phrase found in section 506(a)'s first sentence. These same phrases cannot mean liquidation value when applied in Chapter 13 cases and retail value when applied in Chapter 11 cases. In *Timbers*, this Court recognized the connection between §§ 506(a) and 1129(b)(2)(A)(i)(II) where it stated:

> It is true that under § 1129(b) a secured claimant has a right to receive under a plan the present value of his collateral. This entitlement arises . . . from the provision of § 1129(b)(2)(A)(i)(II) that guarantees the secured creditor "deferred cash payments . . . of a value **as of the effective date of the plan**, of at least the value of such [secured claimant's] interest in the estate's interest in such property."

---

[15](...continued)
"[i]t is incongruous to value a business that is being reorganized on the basis of the price its assets could fetch on a piecemeal liquidation when the entire theory of the reorganization is that the debtor is being preserved as a going concern").

Timbers, 484 U.S. at 377 (emphasis in original). If this fundamental phrase, which pursuant to section 506(a) applies to Chapters 7, 11, 12 and 13, means liquidation value in Chapter 13 reorganizations, then it must also mean liquidation value in Chapter 11 reorganizations.

If *Rash* is affirmed, then in Chapter 11 reorganization cases, where the debtor will retain the operating assets, the allowed secured claim will be measured not by going concern value, but by liquidation value. Capping allowed secured claims at liquidation value will have two effects. First, it will result in a transfer of value from secured creditors to the debtors. As noted above, the Bankruptcy Code's balancing of rights often results in negotiated Chapter 11 plans. Reducing allowed secured claims in reorganizations to liquidation value will shift the balance in favor of debtors and will provide debtors with additional leverage which will enable them to retain more value in Chapter 11 reorganizations. Second, it will decrease the amount paid to the secured creditors, and increase the return to unsecured creditors effectively shifting wealth from partially secured creditors to unsecured creditors. Surely, this was not Congress' intent in drafting Section 506(a) and no economic interpretation ought to lead to this result.

CONCLUSION

For all of the reasons set forth above, your amicus respectfully requests that the decision below be reversed.

Respectfully submitted,

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No. 96-454

In The

Supreme Court of the United States

October Term, 1996

IN RE: ELRAY RASH AND WIFE JEAN RASH,

Debtors,

ASSOCIATES COMMERCIAL CORPORATION,

Appellant,

v.

ELRAY RASH AND WIFE JEAN RASH,

Appellees.

**On Writ Of Certiorari
To The United States Court Of Appeals
For The Fifth Circuit**

AMICUS CURIAE BRIEF OF THE NATIONAL ASSOCIATION OF CHAPTER 13 TRUSTEES IN SUPPORT OF DEBTORS/APPELLEES

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CONSENT STATEMENT

All parties have consented that the National Association of Chapter Thirteen Trustees (NACTT) may file this brief. *Amicus* National Association of Consumer Bankruptcy Attorneys, Inc., files the parties' written consent stating that the NACTT may do so.

INTERESTS OF *AMICUS CURIAE*

The NACTT is a non profit organization, established in 1968, for the purpose of providing educational and training assistance to Chapter 13 trustees and practitioners involved in the consumer bankruptcy process and in Chapter 13 in particular. The NACTT membership includes approximately 95% of the standing Chapter 13 trustees appointed in the United States. In the 12-month period ending June 30, 1996, 305,527 non business Chapter 13 cases were filed in the United States. These cases involve numerous valuation issues, all of which statutorily involve the trustees.

A bankruptcy trustee acts as a fiduciary of all creditors of an estate, charged with the duty to treat all creditors fairly. *In re Cochise College Park, Inc.*, 703 F.2d 1339 (9th Cir. 1983). In so doing, the trustee's duties include maximizing the distribution of funds to all creditors, not simply one creditor over the other. *See In re Consupak*, 87 B.R. 529 (Bankr. N.D. Ill. 1988). The application of the long standing "bankruptcy rule" in valuation of collateral, which establishes the extent of a secured claim in an individual reorganization, has the effect of maximizing a fair return to all creditors, including the general

unsecured creditors. Abandonment of the "bankruptcy rule" through a strained interpretation of 11 U.S.C. § 506, would have the effect of artificially inflating the distribution of available funds in a consumer reorganization to one type of creditor, to the detriment and at the expense of the general unsecured claimholder.

It is entirely appropriate for the NACTT to present this argument to this court, advocating for the clear interpretation of 11 U.S.C. § 506 which preserves the "bankruptcy rule." Trustees under Chapter 13 do not hold any economic interest in the outcome but are statutorily obligated to "appear and be heard at any hearing that concerns . . . the value of property subject to a lien." 11 U.S.C. § 1302(b)(2)(A). The appropriate interpretation of 11 U.S.C. § 506 in Chapter 13 cases has a significant and real impact on the statutory duties of trustees in those cases.

SUMMARY OF THE ARGUMENT

"The bankruptcy rule" provides that to receive dividends from estate proceeds, a secured creditor must first 1) forfeit to the estate his security; or 2) repossess the security, sell it, apply the proceeds to the debt, and prove for the remainder. Thus, in those instances when a security must be valued, the bankruptcy rule views the security from the perspective of how much a creditor would receive for it at resale. At no time has the bankruptcy rule allowed for valuing security based on its replacement cost to the debtor.

In 1800, Congress began enacting bankruptcy statutes. Prior to the 1978 enactment of 11 U.S.C. § 506(a), every pertinent bankruptcy statute provided for valuing secured collateral in a manner consistent with the bankruptcy rule. No statute allowed for valuing security based on its replacement cost to the debtor.

No evidence exists that Congress intended section 506(a) to depart from established practice under the bankruptcy rule. Indeed, the statute's plain language, its legislative history, and events occurring after its enactment, all point to a contrary conclusion.

Valuing the secured portion of Rash's debt to Associates based on proceeds Associates would receive through repossession and resale of Rash's truck is consistent with the bankruptcy rule. Because Congress nowhere indicated that section 506(a) was a departure from practice under this venerable rule, this Court should reject Associate's attempt to achieve a result inconsistent with it.

ARGUMENT

This Court presumes that Congress legislates with knowledge of existing law pertinent to the topic involved. *Cannon v. University of Chicago*, 441 U.S. 677, 696-97, 99 S.Ct. 1946, 60 L.Ed.2d 560 (1979). In the absence of evidence that Congress enacted a statute aimed at achieving a result inconsistent with existing law, this Court interprets statutes consistent with that law. *Goodyear Atomic Corp. v. Miller*, 486 U.S. 174, 184-85, 108 S.Ct. 1704, 100 L.Ed.2d 158 (1988). Because the bankruptcy rule's hoary tradition was well-established at the time

Congress enacted section 506(a), and because no evidence exists that Congress intended that provision to achieve a result inconsistent with that rule, this Court should interpret section 506(a) consistent with the bankruptcy rule. *See Miles v. Apex Marine Corp.*, 498 U.S. 19, 32, 111 S.Ct. 317, 112 L.Ed.2d 275 (1990).

A. The Bankruptcy Rule Existed For 178 Years Prior To The Enactment Of Section 506(a)

In 1800, Congress enacted its first bankruptcy statute. That statute provided that

> In the distribution of the bankrupt's effects, there shall be paid to every of the creditors a portion-rate, according to the amount of their respective debts, so that every creditor having security for his debt by judgment, statute, recognizance or specialty, or having an attachment . . . on the estate of such bankrupt . . . shall not be relieved . . . for more than a ratable part of his debt with the other creditors of the bankrupt.

Act of April 4, 1980, c. 19, § 31, 2 Stat. 30. Given that this language parroted earlier English bankruptcy acts, this Court interpreted it consistent with the construction English judges gave those acts. *See, e.g., Tucker v. Oxley*, 5 Cranch 34, 42 (1809).

Under English bankruptcy statutes existing prior to the Revolution, judges applied "the bankruptcy rule". That rule provides that to receive dividends from estate proceeds, a secured creditor must first 1) forfeit to the estate his security; or 2) repossess the security, sell it,

apply the proceeds to the debt, and prove for the remainder. Thus, in those instances when a value was placed on collateral, the bankruptcy rule commands that the secured creditor *"must have his security sold"* and subtract from the total debt proceeds received from that sale. *Merrill v. National Bank of Jacksonville*, 173 U.S. 131, 153, 10 S.Ct. 360 (1899) (White, J., dissenting) (italics added, citing cases). As one English Chancellor explains, as of 1800 it had been

> long established in bankruptcy not to suffer a creditor holding a security to prove unless he will give up that security, or the value has been ascertained *by the sale of it*. The reason is obvious. Till the debt has been reduced *by the proceeds of that sale*, it is impossible correctly to say what the actual amount is.

Ex parte Smith, 2 Rose 63 (1813) (italics added); *see also Merrill*, 173 U.S. at 173 (Gray, J., dissenting) ("long before the American Revolution, (it had) become the settled practice in the court of chancery, that a (secured creditor) *must have his collateral security sold*, and prove for the rest of the debt only").

Justice Storey drafted the successor to the 1800 act, the Bankrupt Act of 1841. By this time, the bankruptcy rule was so well established that Justice Storey determined that no specific reference to it was required. *See Merrill*, 173 U.S. at 175 (Gray, J., dissenting). In *Ex parte The Bank of New Orleans*, 3 Howard 292, 11 L.Ed. 603 (1845), this Court confirmed that while the 1841 act was silent as to the bankruptcy rule, that rule continued to control the extent to which a secured creditor could prove a claim against a bankrupt's estate. "If [creditors] have a

pledge or mortgage (on a bankrupt's claim), they may apply to the court *to have the same sold,* and the proceeds thereof applied towards the payment of their debts pro tanto, and to prove for the residue." *Id.*, 3 Howard at 315.

In 1867, Congress inserted an express provision codifying the bankruptcy rule. This enactment

> was but the incorporation into the statutes of the rule which had arisen as a consequence of the requirement for a ratable distribution, which had existed for hundreds of years before. . . .

Merrill, 173 U.S. at 161 (White, J., dissenting).

In 1898, Congress enacted the Bankruptcy Act. That act required a secured creditor to deduct the value of his security from his claim before receiving an estate dividend on the remainder of that claim. Consistent with the bankruptcy rule, the value of the security was determined

> by converting the same into money according to the terms of the agreement pursuant to which such securities were delivered to such creditors, or by such creditors and the trustee by agreement, arbitration, compromise or litigation, as the court may direct.

11 U.S.C. § 93(h). Thus, the 1898 Bankruptcy Act preserved as a method of valuation the bankruptcy rule's command that the security be sold. While that act added additional valuation methods, none of those methods involved the collateral's replacement cost to the debtor.

In 1938, Congress enacted the Chandler Act. That act provided that under certain circumstances, debtors could retain and employ items which secured their debts rather

than being required to relinquish those assets to the secured creditor. As Representative Michener explained, under the Chandler Act

> the theory now is to conserve rather than liquidate the estate, give the debtor a chance to work out his financial difficulties and not destroy his business. . . . Possibly he may remain in possession of his property until his creditors are brought to a realization of the fact that perhaps there is more in it financially for them and that it is better for the bankrupt and for the country if the bankrupt is permitted to continue in his business and the creditors compromise their claims.

Cong.Rec.H. 8649 (August 10, 1937).

In a reorganization bankruptcy under the Chandler Act, secured creditors could not file claims or receive estate distributions based on the secured portion of a claim. They could, however, file a claim for the unsecured portion of the debt. Because a bankruptcy reorganization envisioned the debtor retaining the security, the traditional method of valuing the security under the bankruptcy rule, selling it, was unavailable. Thus, courts turned to a logical substitute: estimating proceeds that would result had the secured creditor repossessed the collateral and disposed of it in a commercially reasonable manner. *See, e.g., In re Pennyrich International, Inc. of Dallas*, 473 F.2d 417, 424 (5th Cir. 1973); *In re American Kitchen Food, Inc.*, 2 BCD 715, 722 (N.D. Me. 1976); *In re Garcia*, 396 F.Supp. 518, 521 (C.D. Cal. 1974).

B. Prior To Enacting 11 U.S.C. § 506, Congress Nowhere Indicated It Intended That Statute To Depart From Practice Under The Bankruptcy Rule

The language of section 506 does not in any way indicate that it breaks 178 years of Congressional homage to the bankruptcy rule. Indeed, by providing for valuation of a secured claim based on "*the creditor's* interest in the estate's interest", section 506 conclusively reveals that Congress intended no such break. Consistent with the statute's language, section 506's legislative history nowhere indicates that Congress intended it to deviate from the bankruptcy rule.

Under the Chandler Act, creditors holding security interests in essential debtor property, through threat of repossession, were able to coerce bankruptcy debtors to reaffirm their secured debt. Thus, "the question [was] raised as to how much relief the debtor actually gets." *Report of the Commission on the Bankruptcy Laws of the United States*, H.R. Doc. No. 93-137, 93rd Cong., 1st Sess., (hereafter "Commission Report"), Part I at 3-4. In 1970, Congress created the Commission on Bankruptcy Laws to study this and other problems.

In 1973, the Commission submitted its report to Congress and proposed a new bankruptcy code. In recognizing the trouble created by forced reaffirmation of secured debts, the Commission demonstrated that sale upon repossession continued to provide the baseline from which secured collateral should be valued.

> [A] debtor may face a choice between entering an agreement to reaffirm a debt secured by a

> consensual security interest . . . or submitting to the creditor's repossession of the collateral. . . . In many instances the collateral is essential in the debtor's household or to his employment. Its value to him may be much greater than *the price it obtains at a repossession or foreclosure sale.* Thus, to the extent that the amount of the debt exceeds *the value of the collateral*, the debtor reaffirming a debt loses the benefit of the discharge and of the "fresh start" which it is intended to provide.

Commission Report, Part II, at 131.

While the Commission proposed allowing reaffirmation of secured debt, it proposed limiting such to the "fair market value" of the security. As a method for making this determination, the Commission stated as the most appropriate standard *"the net amount the creditor would receive were he to repossess the collateral and dispose of it as permitted by the applicable bankruptcy law."* Commission Report, Part II, at 131.

After Congress received the Commission's Report, the National Conference of Bankruptcy Judges proposed an alternative bill. While it differed substantially from the Commission's proposal, it also recognized problems arising from forced reaffirmation of secured debt. Like the Commission Report, in doing so it recognized that, consistent with bankruptcy rule, repossession and resale provide the baseline for valuing secured collateral.

> The mere threat of repossession operates as pressure on the debtor to pay the secured creditor more than *he would receive were he actually to repossess and sell the goods.* Current Chapter XIII does little to recognize the differences between

> the *true value of the goods* and their value as leverage. Proposed 13 instead views the secured creditor relationship as a financial relationship, not one where extraneous, non-financial pressures should enter.

Report of the Committee on the Judiciary, House of Representatives, To Accompany H.R. 8200, H.R. Rep. No. 95-595, 95th Cong., 1st Sess. (1977).

The Bankruptcy Code's legislative history nowhere hints of an intent to break with the bankruptcy rule's tradition of valuing secured collateral by reference to proceeds that would result from repossession and resale. Indeed, that history points to a contrary conclusion. Events occurring after Congress enacted section 506(a) confirm that Congress intended continued homage to the bankruptcy rule.

C. After Enacting 11 U.S.C. § 506, Congress Demonstrated That It Did Not Intend That Statute To Deviate From Practice Under The Bankruptcy Rule

Given the language and history of section 506(a), courts interpreted it consistent with the bankruptcy rule's requirement that value of secured collateral was set at an amount that would be obtained from a commercially reasonable disposition of the collateral. *See, e.g., In re Darmron,* 8 B.R. 323, 326 (S.D. Ohio 1980); *In re Savloff,* 4 B.R. 285, 287 (E.D. Pa. 1980). As in this case, credit industry representatives sought to change this result, and in December 1981, S. 2000 was introduced to do so. The Committee Report describes the reason for the proposed change.

> The existing provisions of the Bankruptcy Code stipulate that the value of the property of a debtor's estate must be determined on the basis of the proposed disposition or use of that property. . . . *Many courts have fixated upon wholesale resale (as) the appropriate standard, even for property with a high resale value in the retail market. . . . [T]he proposed bill specifies the preference of the Code for use of a resale market standard. . . .*

Report of the Judiciary Committee to the Senate, Senate Rep. No. 97-446, 97th Cong., 2d Sess. (1981).

In 1983, S. 445 was introduced which contained many of S. 2000's provisions, including an identical proposed change to section 506(a), as well as changes to sections 506(b) and (d). Although Congress did not enact S. 445, Congress did enact that bill's proposed changes to sections 506(b) and (d). Congress did not, however, enact the proposed change to section 506(a). Thus, Congress rejected credit industry overtures to have section 506(a) break from the bankruptcy rule's tradition of valuing secured collateral from the perspective of how much money a creditor could obtain if he repossessed the collateral and sold it.

CONCLUSION

No evidence suggests that Congress intended section 506(a) to depart from the bankruptcy rule. Indeed, section 506(a)'s express language, its legislative history, and events occurring after its enactment, all point to a contrary conclusion. This Court should therefore affirm the decision of the *en banc* Fifth Circuit and reject Associate's attempt to obtain a result inconsistent with the bankruptcy rule's centuries-old tradition.

Respectfully submitted,

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No. 96-454

IN THE SUPREME COURT OF THE UNITED STATES

October Term, 1996

ASSOCIATES COMMERCIAL CORPORATION, PETITIONER

v.

ELRAY AND JEAN RASH, RESPONDENTS.

On Writ Of Certiorari
To The United States Court Of Appeals
For The Fifth Circuit

BRIEF FOR DONALD AND MADELAINE TAFFI AS AMICUS CURIAE SUPPORTING RESPONDENTS

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QUESTION PRESENTED

In a Chapter 13 bankruptcy proceeding, what is the proper method under 11 U.S.C. § 506(a) for valuing a secured creditor's interest in property of the estate which the debtor intends to retain under the Chapter 13 plan.

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IN THE SUPREME COURT OF THE UNITED STATES

October Term, 1996

No. 96-454

ASSOCIATES COMMERCIAL CORPORATION, PETITIONER

v.

ELRAY AND JEAN RASH, RESPONDENTS.

On Writ Of Certiorari
To The United States Court Of Appeals
For The Fifth Circuit

BRIEF FOR DONALD AND MADELAINE TAFFI AS AMICUS CURIAE SUPPORTING RESPONDENTS

INTEREST OF DONALD AND MADELAINE TAFFI

This case presents the issue of how to value the secured claim of a creditor for purposes of paying that creditor's secured claim under a chapter 13 plan where the property securing the claim is to be retained and used by the debtor. Because of the similarities between the provisions governing the payment of secured claims in chapters 11 and 13 of the Bankruptcy Code, the resolution of this case will affect payment of secured claims in both chapter 13 cases and chapter 11 cases. The Taffis are reorganized debtors in a chapter 11 bankruptcy proceeding and currently have a petition for writ of certiorari pending before

this Court in case No. 96-881. This petition was filed to seek review of the Ninth Circuit's decision in the Taffis' case, reported at 68 F.3d 306, aff'd in part on rehearing en banc, 96 F.3d 1190 (9th Cir. 1996).

The Ninth Circuit, in its en banc opinion, held that, for purposes of fixing the amount to be paid to the Internal Revenue Service under a chapter 11 plan on account of a claim secured by a lien on the Taffis' residence, the appropriate method of valuing the IRS's secured claim was to look to the "fair market value" of the residence and subtract the face amount of senior encumbrances. The Ninth Circuit rejected the Taffis' argument that the amount of the IRS's secured claim should be determined by looking to what the IRS would realize if the IRS enforced its lien against the residence, thereby explicitly rejecting the approach taken by the Fifth Circuit in the present case. Affirmance of the Fifth Circuit in the present case would appear to require a reversal of the Ninth Circuit's decision in the Taffis' case. The Taffis therefore have a substantial interest in the outcome of the present case.

The Taffis have received written consent to file a brief as amicus curiae from petitioner and from respondents.

SUMMARY OF ARGUMENT

1. Resolution of the issue presented by this case will affect the amounts paid to all secured creditors by all debtors in all chapter 11 reorganizations and in all chapter 13 cases. The issue presented in this case thus is of the utmost significance in the bankruptcy reorganization process.

2. Bankruptcy Code section 506(a) governs the determination of the amount of a secured creditor's secured

claim for purposes of the bankruptcy process. The statutory language of this section requires the valuation of the creditor's interest in the bankruptcy estate's interest in the property which secures the claim. This valuation process involves not just a determination of the value of the property securing the secured claim but also involves an examination of the attributes and characteristics of the lien or security interest at issue, including the scope of the lien, the lien enforcement mechanisms available to the creditor, the practices of the creditor in enforcing its lien against the property securing the claim, the relative priority of any competing liens and all other relevant characteristics and attributes.

The first step in determining the value of a specific secured claim is to ascertain the specific attributes and characteristics of the lien or security interest in question. This will necessarily involve an examination of state law where the lien arises under state law and is enforced under state law, but federal law may also be relevant to the extent that federal law governs the creation, enforcement or prioritization of the lien or security interest in question.

The second step is to ascertain a value or range of values of the property securing the claim, taking into account the proposed use or disposition of the property under the plan. While different forms of use and different forms of disposition might yield different values, it is not appropriate to assume, without reviewing the evidence relating to each specific form of use and disposition, that the value of the property will always be higher if "used" instead of "disposed of."

The third step is to determine the extent of the bankruptcy estate's interest in the property securing the claim.

The final step is to determine the amount of money that the secured creditor would receive if it enforced the lien or security interest in question against estate's interest in the property securing the claim, taking into account all of the lien's characteristics, the extent of the bankruptcy estate's interest in the property, and the nature and proposed use or disposition of the property securing the claim.

3. Many lower courts have ignored or underemphasized certain steps in the process of determining the value of a secured creditor's claim or else have focused on factors not properly part of the process of valuing the secured creditor's claim. One group of courts has failed to consider all of the characteristics of the lien or security interest. Another group of courts has looked to the "economic benefit to the debtor," notwithstanding the fact that the statutory language and legislative history make such an inquiry irrelevant. Other courts have improperly applied the valuation process, for example, by including in the value of the secured claim the value of the unsecured portion of the claim. Application of the valuation processes advocated by these lower courts leads to illogical results.

Lower courts have also expressed concerns which are either unfounded or which are addressed elsewhere in the Bankruptcy Code. The risk to the secured creditor that there will be a default under the plan as to that creditor is not a factor to be taken into account in determining the amount of that creditor's secured claim.

4. Use of the valuation process outlined above is consistent with the statutory language of section 506(a), the legislative history of section 506(a) and the previous decisions of this Court. This process will not mandate an automatic "wholesale" value or an automatic "retail" value in any given

situation but will instead require an examination of the facts relating to the specific creditor in question, to the specific lien in question, to the specific property in question and to the specific plan in question. In the present case, application of this process requires the affirmance of the Fifth Circuit's decision.

ARGUMENT

RESOLUTION OF THE ISSUE PRESENTED IN THIS CASE WILL HAVE A SIGNIFICANT IMPACT ON ALL BANKRUPTCY REORGANIZATION CASES

Bankruptcy Code section 506(a) governs the determination of the amount of a secured creditor's secured claim for many purposes under the Bankruptcy Code. In the present case the amount of a secured claim is being determined for purposes of paying the secured creditor under the "cramdown" provisions of Chapter 13, which require the payment of the "allowed amount" of the secured claim as defined in section 506(a). 11 U.S.C. § 1325(a)(5). The Chapter 13 cramdown provisions are for all practical purposes identical to the "cramdown" provisions of Chapter 11 governing the payment of secured claims under Chapter 11 plans, which require the payment of the "allowed amount" of the secured claim. 11 U.S.C. § 1129(b)(2)(A)(II). Determination of the manner in which the amount of a secured claim is determined in the present case will therefore have a significant impact on virtually every chapter 11 and chapter 13 reorganization in which a creditor is asserting a secured claim. The importance of the present case can not be overstated. The rule set forth in the Court's opinion will be applied in a host of different factual situations, even if the Court limits its ruling to determining the

amount of a secured claim for purposes of payment of that claim under a reorganization or wage-earner plan.

SECTION 506(A) OF THE BANKRUPTCY CODE REQUIRES CONSIDERATION OF ALL RELEVANT FACTORS IN DETERMINING THE AMOUNT OF AN ALLOWED SECURED CLAIM, NOT JUST CONSIDERATION OF THE VALUE OF THE PROPERTY SECURING THE CLAIM

The language of section 506(a) requires the valuation of the creditor's interest in the estate's interest in the property which secures the claim in question. This language necessitates not only a determination of the value of the property securing the claim, but also an analysis of the secured creditor's rights under the agreement or statute creating lien or security interest which encumbers that property. It is, after all, the lien or security interest itself which differentiates a secured creditor from an unsecured creditor.

In determining the value of the claim secured by a lien or security interest, a determination of the amount which the creditor would receive upon enforcement of that lien or security interest is the key to determining the value of the claim which the lien secures for purposes of section 506(a). *In re Hoskins,* 102 F.3d 311, 317-320 (Easterbrook J., concurring). This determination is similar to the process which would be used by a third party investor who was offered the opportunity to purchase the secured claim. It is difficult to imagine a third party investor arriving at a price they were willing to pay for a secured claim without considering how much money the party would receive in the event it was necessary to enforce the lien

in question against the collateral.[1] Because the statutory language requires the valuation of the secured creditor's interest and not just the valuation of the property securing the lien or security interest in question, all factors which affect the value of the secured creditor's interest are relevant to determining the value of the secured creditor's secured claim. Because the statutory language requires valuation only of the secured portion of the claim and not valuation of any unsecured portion of the claim, the amount of money which the secured creditor would received if it enforced the lien against the collateral is the logical method of fixing the value of the secured claim for purposes of section 506(a).

Determining the value of a specific secured claim necessarily involves several steps because of the numerous factors that are relevant to fixing the value of the secured creditor's interest. The first step is to determine the specific attributes or characteristics, both intrinsic and extrinsic, of the lien or security interest in question. One example of an intrinsic attribute is the fact that the lien attaches only to the asset itself and not to the income produced by the asset -- a simple deed of trust -- or, conversely, that the lien attaches to both the asset and the income produced by the asset -- a deed of trust and assignment of rents. Another example of an intrinsic attribute is the creditor's enforcement mechanism to enforce the lien. The creditor might only be able to foreclose nonjudicially

[1] The most significant difference between a situation involving a potential third-party purchaser of a secured claim and the valuation of a secured creditor's interest under Bankruptcy Code section 506(a) is that the third-party investor is likely to acquire the entire amount of the claim, including the unsecured portion of the claim, while the Bankruptcy Code process involves the valuation of only the secured portion of the claim.

against the property, as is the case under California law with a lien on a residential dwelling which secures a purchase money loan. See Cal. Code Civ. P. § 580b. Conversely, the creditor might be able to appoint a receiver to collect rents and then conduct a judicial foreclosure sale. See Cal. Code Civ. P. §§ 564-570 and § 725a et seq. It requires nothing more than common sense to conclude that these factors affect the value of a secured claim.

One example of an extrinsic attribute which affects the value of a secured claim is the relative priority of the lien or security interest in question vis-a-vis other liens or security interests encumbering the property securing the claim which is to be valued. Other factors or characteristics, such as the habits or practices of the secured creditor, may also be relevant to valuing a secured claim. Evidence that a creditor routinely enforces its liens against motor vehicles in certain ways, which in turn produces certain results, is relevant to determining the value of that creditor's interest as a secured creditor in a motor vehicle. Similarly, evidence that a taxing agency has a strictly enforced policy of never enforcing its lien against the primary residence of a taxpayer as long as the taxpayer continues living in that residence is relevant to determining the value of that taxing agency's secured claim if the property securing the claim is the taxpayer/debtor's primary residence.

Determining these various intrinsic and extrinsic attributes will necessarily involve an examination of state law and, in some instances, federal law, depending on the facts of the case. Security interests governed by state law will require an examination of state law. See, e.g., Cal. Com. Code § 1-201 et. seq. Federal tax liens governed by federal law will require an examination of federal law. See, e.g., 26 U.S.C. section 6321 et seq. Sometimes both federal and state law will be

relevant. For example, a state law-created security interest may attach only to a piece of property and not to the income generated by that property. After the filing of the bankruptcy petition, however, the debtor might enter into an adequate protection agreement pursuant to federal bankruptcy law, 11 U.S.C. § 361, which creates an additional lien in favor of the secured creditor on the income generated by the collateral.

The petitioner's criticism of the Fifth Circuit's examination of state law to assist in reaching a decision is unjustified and is belied by the petitioner's own acknowledgment that state law is relevant to a determination of the value of the secured creditor's secured claim. This Court has previously held that state law should be looked to in a bankruptcy context in those situations where the property rights were created under state law. *Butner v. United States*, 440 U.S. 48 (1979).

At one point petitioner argues that the Fifth Circuit improperly ignores the right under state law to be paid in full. Brief for Petitioner at p. 25. This right, however, is not the sine qua non of a secured claim. A secured claim can exist even where there is no longer any right to obtain payment of the debt. See *Johnson v. Home State Bank*, 501 U.S. 78 (1991). It is the existence of a lien or security interest and property to which that lien or security attaches which is the basis of a secured claim. Consequently, examination of the legal provisions which govern the creation and enforcement of the lien are relevant to valuing the portion of the claim secured by the lien. The existence under state law of the right to be paid a debt in full, over and above the value of the security, is not relevant to valuing the secured portion of a creditor's claim.

At another point petitioner appears to argue that federal law prevents an examination of state law to determine the value

of a secured creditor's secured claim. Brief for Petitioner at pp. 29-31. In the same breath, however, petitioner concedes the relevance of state law. Petitioner states, at page 23 of its brief at footnote 10, that "if part of the value of Rash's truck resulted from accessories that he installed as to which petitioner's lien would not extend as matter of applicable non-bankruptcy law, an adjustment in valuation also would be required." The "applicable non-bankruptcy law" to which petitioner refers in this context is undoubtedly state law governing security interests. In light of petitioners concession that state law governing the creation and enforcement of security interests is relevant to determining the value of petitioner's secured claim, the result which petitioner urges in this case does not make sense.

The United States, in its Brief for the United States as Amicus Curiae, makes the same error. It does not follow that state law governing the creation and enforcement of security interests and liens should be disregarded merely because, as noted by the United States in its Brief at pages 18-19, Congress has enjoined the secured creditor from exercising its lien enforcement rights and has permitted the debtor to retain and use the property securing a secured claim upon the satisfaction of certain requirements. Taking the the United States' argument to its logical conclusion, one could argue that the Bankruptcy Code makes irrelevant the well-established rules governing the creation and enforcement of federal tax liens set forth in 26 U.S.C. section 6321 et seq. for purposes of valuing the secured claim of the Internal Revenue Service. The United States would justifiably protest against such an argument if it were raised.

Once the task of examining the various attributes and characteristics of the lien or security interest in question has been completed, the next step is to ascertain a starting "value"

or range of "values" of the property securing the claim, based upon the proposed use or disposition of the property under the plan of reorganization. Different types of property can be used or disposed of in many different ways. For example, residential real estate could be used as a personal residence, could be used as rental income property, could be sold as "inventory" by a builder of homes, or could be condemned by the state for a public works project. A truck could be used for commuting, could be driven by someone who is paid as a professional truck driver, could be sold to a wholesale truck dealer or could be disassembled for purposes of selling the parts of the truck as spare parts. Each separate use or disposition might yield a different starting "value" or range of "values" of the property securing the claim, but it would be inappropriate to assume, without reviewing the evidence relevant to each separate use or disposition, that the starting "value" of the property will always be higher if "used" instead of "disposed of," regardless of the use or disposition of the property. Similarly, it would be inappropriate to assume that the values generated by any two uses would be the same or that the values generated by any two uses would differ. Each particular use and each particular disposition must be looked at independently.

The assertion by petitioner that " property is worth more when used by the debtor than when disposed of," Brief for Petitioner at p. 35, is not supported by logic or common sense. Property may have less value in the hands of the debtor than if the property were foreclosed on. For example, if the debtor owns real property encumbered by long-term ground leases which call for the payment of rent at rates which are below-market due to changes in the market since the ground leases were entered into, and if a foreclosure by a senior lienholder would eliminate the ground leases under applicable state law, then disposition of the property by way of foreclosure would

increase the value of the property by eliminating the below-market ground leases. There are undoubtedly other examples where property has a greater value after being disposed of than it has in the hands of a bankruptcy debtor, but there is no substitute for a case-by-case analysis based upon the facts of each case.

Even if one assumes that, where the debtor retains the property securing the secured claim, such property "must" be valued at the full fair market value of similarly used property, it does not follow that the value of the secured creditor's secured claim is equal to that full fair market value. As noted above, other factors are relevant to a determination of the value of the secured creditor's secured claim.

The next step is to determine the extent of the bankruptcy estate's interest in the property securing the claim. For example, if a bankruptcy debtor is a 50% owner as a tenant in common with one other unrelated person, the bankruptcy estate will include only the 50% interest of the debtor. 11 U.S.C. § 541.

The final step is to determine, in light of all of relevant attributes and characteristics of the lien, in light of the type of property which secures the claim, in light of the bankruptcy estate's interest in the property, and in light of the proposed disposition or use of that property, the amount of money the enforcement of the creditor's lien against the estate's interest in the property in question would yield the creditor. A secured creditor which holds a lien against both property and the income to be produced by that property under the plan would fare better than the secured creditor which holds only a lien against the property. A secured creditor which holds a lien against both the property and the income produced by that property would fare

better where the proposed use of the property under the plan will generate income than such a creditor would fare where the proposed use of the property under the plan did not produce income. A secured creditor whose enforcement mechanism results in the disposition of the encumbered property on the "retail" market would fare better than the creditor whose enforcement mechanism results in the disposition of the encumbered property on the "wholesale" market.

Each case must be determined on its own facts. A particular secured creditor is free to demonstrate, based on the facts peculiar to that case, that enforcement of its lien against the property securing the claim would produce an amount of money based upon the "retail" value of the property securing the claim, while a debtor is free to demonstrate, based on the facts peculiar to that case, that the enforcement of that lien would produce an amount of money based upon the "wholesale" value of that property.

Many lower court cases have ignored or underemphasized certain of the steps in the process of determining the value of the secured creditor's secured claim set forth above. For example, cases typified by the Ninth Circuit's en banc decision in the Taffis' case, 96 F.3d at 1190, have failed to consider anything other than the value of the property securing the claim and the relative priority of the liens encumbering that property. The Ninth Circuit has deemed many of the characteristics of the lien in question to be irrelevant to a determination of the value of the claim secured by that lien. Thus, under the Ninth Circuit's rule, the holder of a judgment lien would always be treated the same as the holder of a non-recourse mortgage and the holder of a charging order. This is the functional equivalent of attempting to value residential dwellings solely on the basis of the condition of the interior of

the residence, without taking into account the location of the property.

The illogical results of cases such as *In re Taffi* are illustrated by the result in the Taffis' case. The Taffis and the Internal Revenue Service stipulated that the normal fair market value of the property securing the claim in question (the Taffis' residence) was $300,000.00 and that there were liens senior to those of the IRS totalling $234,000.00. The parties further stipulated that the costs associated with a voluntary sale of the property by the Taffis would be $27,000.00 and that, if the IRS administratively enforced its lien against the property, the sale by the IRS would generate gross sales proceeds of $240,000.00, leaving a total of $6,000.00 for the IRS. See 68 F.3d at 307. The Ninth Circuit held that the "value" of the IRS's secured claim was $60,000.00 even though there was no way for either the IRS or the Taffis themselves to obtain the sum of $60,000.00 from the property securing the IRS claim. The most the IRS could have received in enforcing its lien against the property securing its claim was $6,000.00. The most the Taffis could have obtained from this property for the benefit of the IRS was $39,000.00("fair market value" less senior encumbrances and costs of sale), but there was no way for the IRS to compel a voluntary sale by the Taffis. Thus, the Ninth Circuit held that the "value" of the secured claim of the IRS was equal to an amount that was significantly higher than the amount the IRS could have obtained under any circumstances on account of its lien against the subject property.

The Ninth Circuit's rejoinder that it is inappropriate to consider a "hypothetical" enforcement of the lien by the IRS when no such enforcement sale is taking place is a non-sequitur. All valuations, unless they involve the actual sale of the subject property, necessarily involve a "hypothetical" sale. The

question is not whether hypothetical fact situations should be looked to in valuing a secured creditor's claim where the property securing the claim is being retained by the debtor. The answer to that question will always be "yes." The question, rather, is which hypothetical set of facts is the most relevant given that the statutory language requires a valuation of the creditor's interest in the estate's interest in the property securing the claim, not just a valuation of the property securing that claim. For the reasons stated above, the appropriate hypothetical set of facts to look to is a hypothetical enforcement of the secured creditor's lien against the property securing the claim.

Other lower courts have focused on factors that are not properly part of the process of determining the dollar value of a secured claim. In the case of *In re Winthrop Old Farm Nurseries, Inc.*, 50 F.3d 72 (1st Cir. 1995), the First Circuit improperly focused on the "economic benefit for the debtor" in reaching its conclusion, 50 F.3d at 75. The statutory language, however, does not mention the economic benefit to the debtor. In fact, section 506(a) studiously avoids the use of the word "debtor," focusing instead on the creditor's interest in the estate's interest in the property securing the secured claim. Congress used the word "debtor" numerous times throughout the Bankruptcy Code. The absence of the word "debtor" in section 506(a) can not properly be called an inadvertence or an oversight. Focusing on the economic benefit to the debtor of retaining the property would constitute an improper legislative revision of this section by the courts.

A focus on the economic benefit to the debtor of retaining the property in determining the value of a secured creditor's secured claim yields illogical results. For example, one economic benefit to the debtor of not having to move out of

his or her principal residence is the avoidance of moving costs. If the economic benefit to the debtor of being able to retain the residence securing the claim is relevant to determining the value of the secured claim of the creditor holding a lien against the debtor's residence, then the amount of the moving costs avoided by the debtor must be added to the amount of the creditor's secured claim. Similarly, if the debtor, by retaining the property securing the claim, avoids a large income tax liability which would have been incurred upon disposition of the property in question, then the amount of taxes saved by the debtor would have to be taken into account in valuing the secured creditor's secured claim. Such a result is totally illogical and is at odds with the legislative history cited by petitioner at pages 41-42 of the Brief of Petitioner.

Still other lower courts have misapplied the factors to be used in determining the value of a secured creditor's secured claim. Those courts which cite to *In re Green,* 151 B.R. 501, 505 (Bankr. D. Minn. 1993), cited in Brief for United States as Amicus Curiae at pp. 10-11, miss the point. That court stated that "to value [a secured creditor's] interest in property based solely upon the amount that could be realized upon sale of the collateral ignores the value associate with the right to receive the stream of payments that the lien secures." 151 B.R. at 505. The right to receive the payment of the debt, however, is a right associated with an unsecured claim and thus has no relevance in valuing a secured claim. It is the existence of the lien or security interest and the property securing that lien that creates the secured claim. Without these two items, there is only an unsecured debt.

The concerns raised by petitioner are either unfounded or are addressed elsewhere in the Bankruptcy Code. For example, petitioner asserts that the construction of section

506(a) urged by respondents is illogical because it results in the "value" of the secured claim under 11 U.S.C. § 1325(a)(5)(B)(ii) being equal to the "liquidation value" of the secured claim under the best interests of creditors test set forth in 11 U.S.C. § 1325(a)(4), arguably resulting in a surplusage of language. Brief of Petitioner at pp. 17-18. Petitioner is mistaken in this analysis. The "best interest of creditors" test set forth in section 1325(a)(4) (and in 11 U.S.C. § 1129(a)(7)(A)) focuses on what would happen if there was a liquidation by a trustee in chapter 7. A creditor's enforcement of its lien against the property encumbered by that lien will not automatically yield the same result as a liquidation of the property by a chapter 7 trustee. Differences between the manners in which bankruptcy trustees dispose of assets and in which secured creditors enforce their liens can yield significantly different results for the secured creditor. The possibility that, in a given case, the two different hypotheticals (chapter 7 liquidation versus enforcement of the lien by the secured creditor) could yield similar results for the secured creditor does not make these two tests identical.

The petitioner's assertion that the second sentence of section 506(a) is rendered surplusage under respondents' position is refuted by the analysis set forth above. The amount received by a secured creditor which enforces its lien against property could vary where the use of the property varies. This will not always be the case, but an examination of the specific use or disposition of the property securing the claim will always be required. That is all the language of section 506(a) requires. The language does not mandate that different uses must yield different values, does not mandate that different uses must yield similar values and does not mandate that use by the debtor yield a different value than a disposition by a debtor.

The argument that a higher value must be assigned to secured claims because of the risk of a default as to the secured creditor under the plan is likewise without merit. First, in order for the plan to be confirmed, the bankruptcy court must make a factual finding that the debtor will be able to make all payments due to secured creditors under the plan. 11 U.S.C. § 1325(a)(6). Similar safeguards exist in chapter 11. See 11 U.S.C. § 1129(a)(11). If a secured creditor has legitimate concerns about a debtor's ability to pay the secured claim, the secured creditor can oppose confirmation of the plan on the grounds that the requirements of section 1325(a)(6) have not been met.

Second, the secured creditor is already compensated for the risk of default by virtue of the fact that section 1325(a)(5)(B)(ii) requires the payment of the present value of the secured claim. The greater the risk to the secured creditor, the greater the rate of interest that can be sought by the creditor. See *In re Camino Real Landscape Maintenance Contractors, Inc.*, 818 F.2d 1503 (9th Cir. 1987), and *In re Fowler*, 903 F.2d 694 (9th Cir. 1990). Thus, where property is encumbered by first and second deeds of trust, both of which secure valid debts, the holder of the second deed of trust is not compensated for the increased risk associated with being in second position by increasing the amount of its secured claim. Rather, that risk is compensated for by paying the holder of the second deed of trust a higher rate of interest.

Use of the valuation process set forth above for the valuation of secured claims is mandated by the language of § 506(a). The valuation in question is of the creditor's interest in the estate's interest in the property securing the claim. It is not appropriate to value a parcel of real estate without taking into account all relevant factors affecting the value of the real estate,

such as the property's location, the property's condition, any easements on the property, sales of nearby properties, and other factors. Similarly, it is not appropriate to value a secured creditor's secured claim without taking into account all relevant factors, such as those discussed above.

Use of the valuation process set forth above is also consistent with the prior decisions of this Court. In *United Savings Ass'n v. Timbers of Inwood Forest Assocs.*, 484 U.S. 365 (1988), this Court held that the delay in the right to foreclose resulting from the imposition of the automatic stay under 11 U.S.C. § 362 was not an "interest in property" entitling a secured creditor to "adequate protection" under 11 U.S.C. § 361. This Court, in reaching its decision, noted that a contrary result would have meant that the amount of a secured creditor's secured claim increased as the length of the imposition of the automatic stay increased. This Court therefore rejected the notion that the amount of a secured creditor's secured claim should be affected by a delay in the secured creditor's enforcement of its lien against the property securing the claim.

This Court has also held that it is appropriate to look to state law to determine the scope of the interest of a secured creditor in situations where the security interest was created under state law. *Butner v. United States*, 440 U.S. 48 (1979), see also *BFP v. Resolution Trust Corp.*, 511 U.S. 531 (1994).[2] This case should be resolved in the same manner, by looking to

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[2] Petitioner errs in relying on the BFP case in support of its position. The BFP case dealt solely with the value of the property securing a secured claim. The present case deals with the value of the secured creditor's interest in the property securing the claim. As previously noted, the value of the property securing the claim is not dispositive of the value of the secured creditor's interest.

state law to determine the characteristics of a particular lien where that lien is created under state law. Where liens are created under federal law, an examination of the federal law provisions governing creation and enforcement of the liens in question will be in order.

To the extent legislative history is relevant to a resolution of this case, it supports an affirmance of the Fifth Circuit's en banc decision. Congress indicated that it is not appropriate to look to the idiosyncratic value placed by the debtor on the property securing the claim in valuing the amount of a secured claim. H.R. Rep. No. 95-595, at 124, 1978 U.S.C.C.A.N. at 6085. This is another way of stating that it is improper to look to the economic value to the debtor of not having to dispose of the property.

Application of the valuation process set forth above mandates an affirmance of the Fifth Circuit's en banc decision. There apparently is no disagreement over the fact that the value of the secured claim in question fixed by the Fifth Circuit is equal to the amount that the secured creditor would receive if it enforced its lien against the property securing the claim. Because the property securing the claim is only a truck, not the income from the truck and not various components of an ongoing business, this Court need not speculate on how the result reached by the Fifth Circuit would change if the petitioner's lien encumbered both the truck and the income generated by the truck or encumbered all of the assets of the respondent's business. Lower courts will be able to answer those questions as they arise based upon the valuation process set forth above.

CONCLUSION

The judgment of the court of appeals should be affirmed.

Respectfully submitted.

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March, 1997

(15)

No. 96-454

IN THE
SUPREME COURT OF THE UNITED STATES
October Term, 1996

ASSOCIATES COMMERCIAL CORPORATION,
Petitioner,

v.

ELRAY RASH and JEAN E. RASH,
Respondents.

On Writ of Certiorari to the
United States Court of Appeals
for the Fifth Circuit

BRIEF OF AMICUS CURIAE, NATIONAL ASSOCIATION OF CONSUMER BANKRUPTCY ATTORNEYS, INC. in support of Respondents

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IX. APPENDIX 1A

I. QUESTION PRESENTED

Whether, when a debtor proposes to retain a secured creditor's collateral under the cramdown powers of chapter 13 of the Bankruptcy Code, the amount required to be paid on account of the creditor's secured claim is limited to the value that the secured creditor could have obtained if it had sold the collateral at foreclosure.

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III. PERTINENT STATUTORY PROVISIONS

The Appendix includes the text of the following pertinent statutory provisions: 1898 Bankruptcy Act: Chapter X §§ 616(1) & (10); and 1978 Bankruptcy Code: §§ 361, 506(a), 1322(b)(2), 1325(a)(5).

IV. INTEREST OF AMICUS CURIAE

Incorporated in 1992, NACBA is a non-profit organization of more than 700 consumer bankruptcy attorneys nationwide. Member attorneys represent debtors in an estimated 200,000 bankruptcy cases filed each year in the United States. NACBA is the only national association of attorneys organized for the purpose of protecting the rights of consumer bankruptcy debtors.

NACBA's members and their clients throughout the country have a vital interest in the outcome of this case. This Court's decision in this case will determine whether or not Chapter 13 plans are feasible in many thousands of cases each year. A significant percentage of Chapter 13 cases filed involve the payment of secured claims pursuant to 11 U.S.C. § 1325(a)(5). Those cases will be directly affected by this decision.

Counsel for both Petitioner and Respondents have consented to the filing of this *amicus curiae* brief.

V. STATEMENT OF FACTS

Elray and Jean Rash (hereinafter called "Rash") made a $16,000 down payment and financed the remaining purchase price of a commercial truck. Associates Commercial Corporation (hereinafter called "Associates") bought the loan and associated security interest from the original lender. According to normal practice in the trucking business, Rash then leased his vehicle to a transportation company for which he drove the truck. Rash's income from operation of the truck came from the transportation company primarily in the form of lease payments. Associates did not have any security interest in Rash's lease with the transportation company. Associates held only a security interest in the vehicle itself and not in the rents, profits, or proceeds from the use of the truck. After paying Associates for

almost three years, Rash encountered significant financial problems and was forced to file a petition for Chapter 13 relief. 90 F.3d at 1038-39.

The value of Associates' secured claim became an issue in connection with the confirmation of Rash's Chapter 13 plan. 11 U.S.C. § 1325(a)(5)(B)(ii) requires that if a Chapter 13 debtor retains property securing a claim, the Chapter 13 plan must provide for payments to the creditor in the amount of the secured claim. If the debtor elects to surrender the property securing the claim through the Chapter 13 plan, § 1325(a)(5)(C) applies and no valuation of the secured claim is undertaken. The secured claim is valued for purposes of § 1325(a)(5) (confirming a Chapter 13 plan) *only* if the property is to be retained and used by the debtor. The amount to be paid to the creditor (the allowed secured claim) is valued pursuant to 11 U.S.C. § 506(a).

The "cram down" or "strip down" provision in a reorganization plan limits the portion of the debt which must be fully repaid to the amount of the secured claim. 11 U.S.C. § 1322(b)(2) further authorizes Rash to modify Associates' rights to accomplish the § 1325(a)(5)(B) cram down.

VI. SUMMARY OF ARGUMENT

Before the 1978 Bankruptcy Code was adopted, secured creditors were not entitled to bankruptcy estate distributions based upon their secured claims. For consumer debtors, § 1325(a)(5)(B), adopted in 1978, provided the first clear statutory right to retain property securing claims and pay for it through the Chapter 13 plan. (See Appendix for statutory provision).

Amicus contends that the value of Associates' secured claim is the amount Associates would expect to net upon a hypothetical surrender of Rash's truck on the bankruptcy petition date. This amount is not a "liquidation value" or a "forced sale value" which would be obtained by a bankruptcy trustee. It is the amount Associates routinely realizes on repossessed or surrendered vehicles *outside* of bankruptcy in dispositions under applicable state or non-bankruptcy law. Associates asserts that the value of its secured claim for purposes of § 1325 should be what Rash

would pay for an identical replacement vehicle, or the "retail" value.

The plain meaning of § 506(a) clearly supports Rash's position: the secured claim is the value to the creditor of its interest in the estate's interest in the property. See Appendix for statutory provision. The "creditor's interest" can have no meaning if the debtor's interest is the interest being measured. If Congress had intended the secured claim to be measured by the value to the debtor of retaining or using the vehicle, Congress could have simplified § 506(a) to read "an allowed claim of a creditor ... is a secured claim to the extent of the value of the use to the debtor of the property securing the claim." See similar language in § 1325(a)(5)(C). (See Appendix for statutory provision). Congress has considered and rejected the meaning Associates proposes several times, see *infra*.

Any confusion regarding the meaning of § 506(a) can be resolved by analyzing the various contexts and purposes in which it may be utilized, including those other than determining the amount that must be paid on a secured claim in a Chapter 13 plan pursuant to § 1325. Most courts have found the first sentence of § 506(a) to be unambiguous, and the second sentence of § 506(a) also has meaning when analyzed in connection with other sections of the Bankruptcy Code. Contrary to the position taken by Associates, the second sentence does not mean that "retail" value applies in the case at hand. However, if this Court finds the statute to be ambiguous, the legislative history of the 1978 Bankruptcy Code and the pre-Code rule also clearly support Rash's position.

Hundreds of years of legal tradition provide the origin for the pre-Code rule. The "bankruptcy rule," dating back to Henry VIII, provides that in order to share in unsecured dividends, secured creditors were first required to repossess and dispose of the security and apply the net proceeds to the debt. Actual application of net proceeds of the repossession was the rule when liquidation was the only bankruptcy relief available.

With the introduction of bankruptcy reorganizations in response to the depression of the 1930s, debtors were allowed to retain secured collateral. As interpreted in the 1930s, the "bank-

ruptcy rule" determined the secured claim amount by deducting the expected proceeds from a hypothetical judicial sale as established by appraisal. The creditor was entitled to file a claim for the remaining portion of the debt, the unsecured claim. In a later development, the creditor was allowed to bid at a subsequent sale of the property up to the full amount of its claim. This allowed the creditor to bid in an amount that it would expect to recover in a hypothetical repossession.

As discussed below, to diverge from the "bankruptcy rule" and value Associates' secured claim at higher than the expected net recovery on a hypothetical surrender of the property would result in an ***elimination*** of any dividends to be paid to Rash's general unsecured creditors. 90 F.3d at 1055, fn. 24. If a debtor is not able to propose a feasible Chapter 13 plan, he will be forced to elect Chapter 7 relief instead. If the debtor resorts to Chapter 7 relief, the unsecured creditors will invariably receive no dividends and the partially-secured creditor (e.g., Associates) will probably repossess the vehicle because the debtor cannot maintain the contractual payments. The debtor will no longer have transportation to work (or in Rash's case -- the means of directly generating income). Correspondingly, the creditor will have the repossessed vehicle which is worth to it only what Rash proposes to pay through the plan.

This is precisely the result Congress intended to avoid by enacting § 1325(a)(5)(B). As far back as the 1930s, Congress concluded that because of the losses suffered by all parties in a straight bankruptcy (Chapter 7 liquidation), reorganization of the debtor would frequently be in the best interest of the debtor and creditors alike.

VII. ARGUMENT

A. 11 U.S.C. § 1322(b)(2) ALLOWS RASH'S CHAPTER 13 PLAN TO MODIFY THE RIGHTS OF ASSOCIATES

Rash's power to modify Associates' rights as provided in his Chapter 13 plan can be traced back to the Bankruptcy Act of 1898, as amended in 1938. Composition reorganization plans which discharged a portion of the unsecured debt were not commonly utilized until the 1930s, culminating with the amendment of the 1898 Bankruptcy Act in 1938. See *Dewsnup v. Timm*, 502 U.S. 410, 112 S.Ct. 773, 778-9 (1992), and the 1898 Bankruptcy Act: 11 U.S.C. Chapter X § 616(1) & (5).

The Bankruptcy Code enacted in 1978, provided an important change empowering consumer debtors to modify the rights of partially secured creditors and pay secured claims in bankruptcy. §§ 1322 and 1325. Under the 1978 Code, §§ 1322 and 1325 closely mirror the provisions of § 616(1) and (10) of the 1898 Act.

B. 11 U.S.C. § 1325(a)(5) ALLOWS RASH TO RETAIN ASSOCIATES' SECURITY IF ASSOCIATES IS COMPENSATED FOR ITS SECURED CLAIM

If a financially distressed debtor files a Chapter 13 bankruptcy case, the debtor is permitted to retain and use his/her property, including property which secures a creditor's claim. With regard to secured debt, the debtor must comply with the requirements of 11 U.S.C. § 1325(a)(5) for the Chapter 13 plan to be confirmed.

Because Associates did not accept the plan, Rash's plan shall be confirmed by the court if Rash either surrenders the property pursuant to § 1325(a)(5)(C) or proposes a plan which complies with § 1325(a)(5)(B). Section 1325 provides the two alternative methods, (B) and (C), of compensating a secured creditor for its security interest. If the debtor elects the option provided in § 1325(a)(5)(C), the secured creditor will receive its security, the value of which to the creditor will be the net recovery on the creditor's actual disposition of the property securing the lien -- meaning that it is valued from the creditor's perspective. If the debtor elects to retain and use the property, the creditor retains its lien and becomes entitled to payment of the present value of the secured claim from the bankruptcy estate over time.

Those two methods of compensating the creditor for its secured claim, in cash or in kind, should logically result in equivalent compensation to the secured creditor. The equivalent amount in cash (through payments from the Chapter 13 trustee) would be measured by the expected net recovery on a hypothetical surrender of the property securing the lien -- also valued from

the creditor's perspective.

Associates argues that the secured claim amount should be higher if the debtor retains and uses the property. Section 1325(a)(5) does not provide for any bonus to the creditor or penalty to the debtor if the debtor elects to retain and use the property instead of surrendering it. In fact, if the debtor elects to surrender the property through the Chapter 13 plan no judicial valuation of the secured claim is undertaken at all. The secured claim is valued for the purposes of confirming a Chapter 13 plan *only* if the property securing the lien is to be retained and used by the debtor.

Associates' position that the secured claim should be a higher amount is unfounded, but there are other protections granted in the Bankruptcy Code to secured creditors if the debtor elects to retain and use the property. If the debtor retains the property, the secured claim will be paid over time by the Chapter 13 trustee. Section 1325(a)(5)(B)(ii) provides that the *present* value of the secured claim will be paid to the creditor, even if in deferred payments. This means that the secured creditor will receive separate and additional compensation for the delay in payments -- often referred to as payment for the "time-value of money." *Rake v. Wade*, 508 U.S. 464, 113 S.Ct. 2187, 2192 [footnote 8] (1993).

In addition, debtors are required to "adequately protect" the security or the creditor may obtain relief from the automatic stay imposed by 11 U.S.C. § 362 and repossess the property. This adequate protection does not increase the value of the secured claim. Similarly, the compensation for deferred payments (time-value of money) does not increase the value of the secured claim.

This Court, in *United Sav. Ass'n v. Timbers of Inwood Forest Assocs.*, 484 U.S. 365, 108 S.Ct. 626 (1988), addressed the issue of adequately protecting undersecured or partially secured claims. This Court found that in bankruptcy an undersecured creditor such as Associates does *not* have the right of immediate foreclosure for which it must be compensated if the debtor retains the securing property. The Court found that the secured creditor is entitled to adequate protection (which may be periodic payments on the principal, insurance, etc.) but that additional compensation for being prevented from foreclosing on the asset, the "use value," is ***not permissible***. In essence, that is what Associates is demanding in this case: *additional* compensation because the debtor is allowed to retain and use the truck, contrary to this Court's holding in *Timbers*.

Associates asserts that by receiving payments for its secured claims over time it is forced to assume a risk of non-payment by the debtor and dismissal of the case. Pet. Brief 34. Associates complains that its security interest will thus be jeopardized. This concern is unwarranted, however, because Associates would retain its lien on the vehicle until the secured claim is fully paid. Therefore, if the case is dismissed before full payment of the secured claim, Associates will be able to exercise its lien rights under state law by repossessing the vehicle.

Associates also expresses concern that the vehicle may depreciate faster than Associates will receive payment on the secured claim. Pet. Brief 34. However, this concern fails to take into account that the debtor is required to adequately protect the creditor as to its secured claim and assure that the payments made to the creditor will at least keep pace with the rate of depreciation of the asset securing the claim. If the creditor detects that depreciation is outstripping payments, the creditor is entitled to move for relief from the automatic stay or for an order requiring additional adequate protection. Non-bankruptcy law does not offer this protection for Associates. Outside of bankruptcy, if a borrower's contract payments do not keep pace with depreciation of the property, the creditor would not have the ability to increase the contract payments. The present bankruptcy law was specifically designed to protect the secured creditor from the erosion of the relative value of its security. These provisions completely protect Associates from the risks cited.

C. ASSOCIATES' SECURED CLAIM IS VALUED PURSUANT TO 11 U.S.C. § 506(a)

The amount to be paid to the creditor under § 1325, the allowed secured claim, is valued pursuant to 11 U.S.C. § 506(a).

1. PLAIN MEANING OF § 506(a)

This Court, in *U.S. v. Ron Pair Enterprises*, 489 U.S. 235,

109 S.Ct. 1026, 103 L.Ed.2d 290 (1989), and in *Dewsnup v. Timm*, supra, set forth the process for determining the meaning of federal statutes, and particularly 11 U.S.C. § 506(a). First, the statute is analyzed to ascertain if it has a "plain meaning" consistent with the overall statutory scheme. If the statute is ambiguous and has no "plain meaning" the court reviews the statutory and judicial "slate" which was written upon by Congress in adopting the statute in question. The prior body of law on the issue must be considered to determine whether the questioned statute changed the prior law. If the statute has changed prior law, a review of the statute's legislative history determines whether Congress specifically intended to make that change. In the case *sub judice*, the plain meaning of § 506(a) clearly supports Rash's position.

2. THE FIRST SENTENCE OF § 506(a)

The first sentence of § 506(a) sets out a two-step process for valuing secured claims. In addition, the first sentence provides a creditor with a setoff right to the extent of the value of that setoff. The first step is to determine the "estate's interest" in the property.

(a) The "Estate's Interest"

The filing of a bankruptcy creates a bankruptcy "estate" which, pursuant to § 541, succeeds to the debtor's interests in property. The estate's interest in the asset which secures the creditor's claim defines the scope of the property interest and identifies the asset in question. Beginning the two-step process by identifying the "estate's interest" sets that as an upper limit on the value of the secured claim. See *GMAC v. Valenti*, 105 F.3d 55, 60 (2nd Cir. 1997); *Associates v. Rash*, 90 F.3d at 1043-44 (5th Cir. 1996).

(b) The "Creditor's Interest"

The second step is to value the "creditor's interest" in the "estate's interest" in the property. In the context of § 1325(a)(5)(B), the value of the creditor's interest is measured by the amount the creditor would receive if the debtor surrendered the property to the creditor and the creditor exercised its rights under the security agreement or other lien to dispose of the property under applicable non-bankruptcy law.

This Court's decision in *United Sav. Ass'n v. Timbers of Inwood Forest Assocs.*, supra, 108 S.Ct. at 630, affirms that the creditor's property right for which it must be *compensated* is measured only by the underlying value *to the creditor* of its security interest. This Court refused to find any basis for further compensating a partially secured creditor for impairing its *contract* right to immediate repossession and disposition:

> "In subsection (a) of [506] the creditor's 'interest in property' obviously means his security interest without taking account of his right to immediate possession of the collateral on default. If the latter were included, the 'value of such creditor's interest' would increase, and the proportions of the claim that are secured and unsecured would alter, as the stay continues -- since the value of the entitlement to use the collateral from the date of bankruptcy would rise with the passage of time. No one suggests this was intended."

Associates asserts that "it is the collateral that must be valued," implying that the truck itself must be valued rather than the creditor's interest in it. Associates cites the next sentence in *Timbers* in support of its position. As proof of its assertion, Associates claims that "the phrase 'value of such creditor's interest' in § 506(a) means 'the value of the collateral.'" Pet. Brief 11. Associates asserts that "the value of the collateral" means the amount the debtor would have to pay to replace the asset. Associates' conclusion is without basis because in this context "collateral" has a different meaning than that assumed by Associates.

Associates fails to account for this Court's very next sentence in *Timbers*: "We think the phrase 'value of such entity's interest' in § 361(1) and (2), when applied to secured creditors, means the same [as in § 506(a)]". Section 361(1) and (2) both refer to "the value of such entity's interest in such property", and § 361(3) authorizes the court to grant such other relief ... as "will result in the realization by such entity of the indubitable equivalent of such entity's interest in such property." Therefore, this

Court, in *Timbers*, used phraseology which indicates valuation from the creditor's perspective. This Court's description of the meaning of "entity's interest" in § 361 clearly envisions valuation of the secured claim from the creditor's perspective, not from the debtor's perspective.

Looking more closely at this Court's decision in *Timbers*, the phrase "value of the collateral" is used elsewhere in several places to mean either: 1) "the value of the security interest in the subject property" or 2) the value of the securing property. Given the context of other usages within *Timbers*, it is more likely that when this Court said "value of the collateral," it meant the more precise "value of the *security interest* in the subject property," rather than "value of the subject property itself."

As an example, this Court, in *Timbers* at 629, states that § 362 stays "actions taken to realize the *value of collateral* given by the debtor." [Emphasis added]. "Collateral" in this usage means the "security interest in the securing property." At 633, this Court discusses collateral further:

> "The phrase ['indubitable equivalent'] has developed a well-settled meaning connoting the right of a secured creditor to receive present value of *his security* ... a secured claimant has a right to receive under a plan the present value of *his collateral* [emphasis added]"

Given the overall holding in *Timbers*, it is unlikely that this Court intended to set the secured claim amount determined pursuant to § 506(a) at the value of the securing property to the debtor. This result is even less likely to have been intended considering the fact that in *Timbers* the "value of such creditor's interest" under § 361 ($4,250,000) was described by this Court as "the estimated amount realizable on foreclosure," at 629. And, this value was equated to the "value of such creditor's interest" under § 506(a), at 630.

In *BFP v. Resolution Trust Corp.*, 511 U.S. 531, 114 S.Ct. 1757, 1762 (1994), this Court held that it was inappropriate to expect the foreclosure value of a house to be "reasonably equivalent" to the value of it on the open market:

> "An appraiser's reconstruction of 'fair market value' could

> show what similar property would be worth if it did not have to be sold within the time and manner strictures of state-prescribed foreclosure. But property that *must* be sold within those strictures is simply *worth less*."

Associates' assertion that the value of its interest in the truck (a foreclosure value) equals the value of the truck on the open market -- its replacement or retail value -- is equally incongruous. In light of the holding in *BFP*, the creditor's interest simply cannot be equivalent to the value of the property on the open market or in the hands of the debtor.

In *Butner v. United States*, 440 U.S. 48, 55, 99 S.Ct. 914, 59 L.Ed.2d 136 (1979), this Court held that unless otherwise provided in federal law, property interests including security interests are created, defined and applied under state law (or non-bankruptcy law) rather than federal bankruptcy law. Therein lies the requirement to apply state commercial statutes to determine the value to the creditor of its security interest given its rights and responsibilities in repossessing property securing the debt, disposing of it, and accounting to the debtor for the proceeds of that sale. *Rash*, 90 F.3d at 1042; *NBD Bank v. Hoskins*, 102 F.3d 311, 316; 317-318, (7th Cir. 1996), J. Easterbrook concurring.

No portion of § 506(a) or § 361(1), (2), or (3) calls for the valuation of the asset securing the debt, nor does any such provision call for a valuation of the cost to the debtor to replace the securing asset. If Congress meant to value the "debtor's interest" in the property rather than the "creditor's interest" in these sections, it could have said so easily. It did use that term in other sections of the Bankruptcy Code including §§ 363(l), 522(d), and 541. In *Chicago v. Environmental Defense Fund*, 511 U.S. 328, 114 S.Ct. 1588, 1593 (1994), this Court held that:

> "[I]t is generally presumed that Congress acts intentionally and purposely when it includes particular language in one section of a statute but omits it in another."
> [internal quotation marks omitted, as cited in *BFP v. Resolution Trust Co.*, 511 U.S. 531, 114 S.Ct. 1757, 1761 (1994)]

Similarly, if Congress intended, for the purpose of § 1325(a)(5)(B), that the secured claim equal the value to the

debtor of the "property securing such claim" it would have written § 1325(a)(5)(B)(ii) to read "the value to the debtor of the debtor's use of the property securing such claim."

(c) Section 553 Setoffs

Section 506(a) also provides that a creditor's claim is secured to the extent it is subject to setoff under § 553. The creditor's secured claim is valued at the amount the creditor would otherwise owe to the debtor (from the creditor's perspective), although application of the setoff requires the creditor to first obtain relief from the automatic stay. A creditor's right to setoff a debt he owes to the debtor can be traced far back in time as a corollary to the Bankruptcy Rule (see *infra*). See *Scott v. Armstrong*, 146 U.S. 499, 511, 13 S.Ct. 148, 151 (1892).

3. The Second Sentence of Section 506(a)

(a) "Such value"

The second sentence begins with "Such value," thus referring back to the value established in the first sentence of § 506(a). The meaning of the second sentence must elaborate on the valuation process set forth in the first sentence. The second sentence cannot be read to negate the first sentence, which would be the result of adopting the creditor's meaning of the second sentence.

In *Rake v. Wade*, 508 U.S. 464, 113 S.Ct. 2187, 2192 (1993), this Court noted that: "We generally avoid construing one provision in a statute so as to suspend or supersede another provision." See also *Ex Parte Public Nat. Bank of New York*, 278 U.S. 101, 104, 49 S.Ct. 43, 44,73 L.Ed. 202 (1928) (quoting *Washington Market Co. v. Hoffman*, 101 U.S. 112, 115, 25 L.Ed. 782 (1879)). This principle of statutory construction must apply even more certainly to two sentences within the same code section. See also *United States v. Nordic Village Inc.*, 503 U.S. 30, 112 S.Ct. 1011, 1015, 117 L.Ed.2d 181 (1992).

(b) "In light of"

Congress intended that courts take the factors mentioned in

the second sentence into consideration when valuing a secured claim. Congress recognized the full spectrum of circumstances in which secured claim valuations might occur. Congress wisely understood the difficulty of prescribing a precise formula that would equitably apply in all circumstances. The second sentence is not intended to contradict the first sentence, but rather to enhance its meaning.

The phrase "in light of" allows the judge discretion, and does not bind the court to a valuation based upon the debtor's proposed use of the property. As the court in *Speck v. United States*, 104 B.R. 1021, 1023 (D.S.D. 1989), stated: "While the use proposed by the debtor should be considered in determining the value of collateral, the bankruptcy judge should not have his hands tied."

(c) The "Purpose of the Valuation"

A § 506(a) valuation for the *purpose* of determining the amount to be paid on a secured claim pursuant to § 1325 is only one of many such purposes. Other possible purposes include: 1) determining a debtor's eligibility for Chapter 13 protection under § 109(e); 2) assessing adequate protection for a creditor requesting stay relief under § 362; 3) assessing adequate protection or dividing the proceeds where a debtor proposes a disposition or use other than in the ordinary course of business under § 363; 4) determining whether a preference occurred under § 547; 5) fixing the redemption amount due to the creditor pursuant to § 722; and 6) determining confirmability of Chapter 11 and Chapter 12 plans. As noted in 506(a)'s legislative history [S. Rept. No. 95-989 to accompany S. 2266, 95th Cong., 2d Sess. (1978)]: "To illustrate, a valuation early in the case in a proceeding under sections 361-363 would not be binding upon the debtor or creditor at the time of confirmation of the plan."

This legislative history was based upon the pre-Code rule. Under the 1898 Bankruptcy Act, valuing secured claims early in a case was necessary to determine the voting rights of partially secured creditors who could only vote based upon the unsecured portion of their claim. 3 *Collier on Bankruptcy* (14th ed. 1977) ¶ 56.07. The Chandler Act amended § 57(e) of the 1898 Act to

provide that the "value of [secured creditors'] securities may be valued *temporarily*" [emphasis added] in order to enable partially secured creditors to participate in creditors' meetings. 3 *Collier* (14th ed. 1977) ¶ 57.01[2.1].

Therefore, the concept of permitting different secured claim valuations at different stages of the case is historically based, and Congress intended to retain that flexibility when § 506(a) was drafted. See also *In re Pine Gate Assoc.*, 3 B.C.D. 301 (N.D.Ga 1977) which also illustrated the need for flexibility in valuation, particularly for different purposes in a case.

(d) The "Proposed Disposition or Use"

The few decisions that have held that "retail" valuation of secured claims is mandated by § 506(a) state that the second sentence of § 506(a) has no meaning whatsoever if expected net recovery upon hypothetical repossession or surrender will apply in all cases. These decisions refuse to recognize that some types of securing property do in fact have substantially different values if used in different ways. One example of real property which falls into this category is land which could be used for farming (lower value) or residential development (higher value). See *In re Foster*, 79 B.R. 906 (Bankr.D.Mt. 1987) which valued the secured claim based upon the debtor's lower-valued use; but see *In re Ehrich*, 109 B.R. 390 (Bankr.D.S.D. 1989) and *In re Sherman*, 157 B.R. 987 (Bankr.E.D.Tex. 1993) where the secured claim was set at a higher-value use than that proposed by the debtor.

And, even within the category of farm land, there are uses which result in different values: pasture land (lower value) versus crop land (higher value). An example of how the proposed "disposition or use" will change the value of a secured claim is contained in *Speck v. United States*, 104 B.R. 1021 (D.S.D. 1989). In *Speck*, in the context of a Chapter 12 plan confirmation the Court held that the farm land need not be valued at the use proposed by the debtor -- pasture land -- but valued it at the higher value of crop land for which it was also suited.

Speck is an excellent example of how the Bankruptcy Code, particularly § 506(a), gives bankruptcy courts the power to cause the debtor to make reasonable economic use of the securing asset. In practice, the fact that the second sentence of § 506(a) does not "tie the judge's hands" carries out the intent of Congress to allow the debtor flexibility in proposing a particular use of a securing asset, but also assures the creditor that an economically infeasible use can be disapproved.

Different possible leases can define different uses and corresponding values for a particular property also. For example, leasing out individual apartments in a building is a different use than leasing out the building as a whole, and these uses can produce different values for the underlying building. See 6 *Collier on Bankruptcy* (14th ed. 1977) ¶ 3.27. Another example under the Act where the proposed use by the debtor or trustee was important in determining the value of secured claims (6 *Collier on Bankruptcy* (14th ed. 1977) ¶ 9.12) involved valuing yarn as waste torn from machinery or as in saleable condition. *In re Meinhard, Greef & Co. v. Edens*, 189 F.2d 792 (4th Cir. 1951).

Creditors secured by different types of real property, business products, or combinations of business equipment are familiar with the impact of the debtor's proposed use on the value of their particular type of security. A vehicle lender, such as Associates/Ford Motor Credit, may view § 506(a) only from the perspective of the type of property securing its claims and may not be able to imagine the meaning and use of the second sentence of § 506(a). Regardless of whether a vehicle is driven for personal or for business use, its value will normally not increase or decrease. A car that is converted for use as a taxi may have less value than a similar car used for personal transportation. But in most cases, a vehicle's value will not vary due to the use proposed by the debtor. And, because the debtor's type of use of a vehicle does not normally affect its value, Associates incorrectly looks elsewhere to find meaning for the second sentence of § 506(a).

One example of another type of "disposition or use" is a sale by the trustee or debtor after plan confirmation and during the course of the case by judicial sale or a voluntary negotiated sale. Similar to the 1898 Act, the 1978 Bankruptcy Code envisioned

the possibility that a proposed sale later in a case could be at a higher price than reflected in an earlier valuation of a secured claim under § 506(a), such as for the purpose of confirming a Chapter 13 plan under § 1325. Congress intended to assure that the secured creditor was not prejudiced by an *earlier valuation* of the secured claim. In a sale later in the case, the creditor could receive up to the full payment on the debt if proceeds are available (after crediting the debtor for payments made on the secured claim, other contributions, and appreciation).

Section 363(k) provides a secured creditor the right to bid at such a sale of the securing asset proposed by the trustee or debtor, including a sale "free and clear" of the partially secured creditor's interests. The right of a secured creditor to bid at a sale of the securing asset is an historically important right that Congress sought to protect in drafting the second sentence of § 506(a) in order to protect the partially secured creditor's property interest (its security interest). *Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555 (1935); *Wright v. Vinton Branch of the Mountain Trust Bank*, 300 U.S. 440 (1937); and *Wright v. Union Central Life Insurance Co.*, 311 U.S. 273 (1940). Understanding of this important purpose and corresponding Congressional intent in drafting the second sentence of § 506(a) has been absent from the analyses by the courts which have adopted the retail, mid-book, or similar positions.

Creditors have said that the debtor may decide not to simply retain and use the vehicle, but may later sell the vehicle at retail value and pocket the profit. This could not happen, however. If the debtor sold the vehicle later, the creditor would be entitled to a new § 506(a) valuation. This is because court approval of a § 363 voluntary sale is a *different purpose* of valuation than a § 1325(a)(5)(B) valuation. And in any case, the debtor would not be able to sell the vehicle for retail value. Retail value is what a car dealer can expect his professional staff to obtain and which an individual cannot expect to obtain. Retail value includes a markup for the car dealer's costs in maximizing the sales price.

Petitioner and Petitioner's *amicus curiae* (American Automobile Manufacturers Association [AAMA]), have questioned

how a particularly detrimental use of the security should affect the valuation of the secured claim. Pet. Brief 15-16. AAMA's Brief 12, fn 4. While the proposed use should be considered by the court in valuing the creditor's secured claim, this *amicus* agrees with Petitioner that a highly depreciating use, if approved by the bankruptcy court, would require higher adequate protection payments to the creditor under §§ 361 and 363, but would not increase the value of the secured claim. This result would require the debtor to pay the secured claim faster in order for the payments to at least keep pace with the depreciation.

Associates (Pet. Brief 13-14) asserts that its claim should not be valued on a "theoretical 'disposition'" by the creditor if the debtor is retaining the asset. However, in all cases where the debtor is retaining the asset, the valuation must necessarily be based upon a hypothetical (theoretical) event. Associates' argument that valuing the secured claim should be based upon Rash's retention of the truck is flawed, because Associates' view also envisions a hypothetical event -- a purchase by the debtor. And, while there is much statutory authority for using the hypothetical recovery to the creditor, there is *no* statutory authority for using the hypothetical cost of replacement to the debtor. Both views are hypothetical by necessity because the property is not in fact being sold.

As has been shown, Congress intended different methods of valuation to be used for different purposes. *Expected net recovery upon hypothetical surrender of the collateral* is the appropriate measure where the debtor elects to retain the security and allows the creditor to retain its lien pursuant to § 1325(a)(5). This method of valuation is appropriate because it measures the creditor's interest in the estate's interest, it considers the proposed normal use of the truck, and it is also equivalent to the alternative form of payment to the creditor under § 1325(a)(5)(B) -- "in kind" which would be a surrender of the collateral.

4. Inapplicability of "Going Concern Value"

Some cases have found that the proper standard for valuing a secured claim should be the "going concern value." Most of these cases are Chapter 11 or 12 cases where the security is, in

fact, a "going concern," secured by an operating business or an operating farm which could be sold as a functioning unit by a foreclosing creditor. In these cases, the "going concern value" is the value the entire operating business would realize if sold intact. This "going concern" value is contrasted with the liquidation value that would be realized if each individual asset of the operating business was disposed of separately.

The concept of "going concern" was described by this Court in connection with a railroad reorganization, in *Continental Illinois Nat. Bank & Trust Co. v. Chicago, R.I. & P. Ry. Co.*, 294 U.S. 648, 671, 55 S.Ct. 595, 79 L.Ed. 1110 (1935):

> "A railway is a unit; it can not be divided up and disposed of piecemeal like a stock of goods. It must be sold, if sold at all, as a unit and as a *going concern.*" [Emphasis added].

Associates' only security is Rash's truck. 90 F.3d at 1039. "Going concern value" is completely inapplicable in this case, because there simply is no other security beyond the vehicle itself.

In *Timbers*, the creditor had an unperfected (and therefore unenforceable under the then-applicable Bankruptcy Code) assignment or lien on rents of the apartment building in addition to a security interest on the building itself. This Court held that to pay an undersecured creditor additional compensation for the delay in foreclosure would have the effect of creating for the undersecured creditor a previously nonexistent security interest -- a *perfected* lien on future proceeds, product, offspring, rents, or profits.

Associates does *not* hold a lien on future proceeds such as Rash's operating lease or his income produced under the lease. Applying this Court's holding in *Timbers* to the facts in this case, no lien on Rash's future income should be created where it does not in fact exist. This Court pointed out the inequitable nature of such a result, vis a vis other legitimately secured creditors, in *Timbers*, at 631-2: "the undersecured creditor who lacks such a perfected security interest [in post-petition rents and proceeds] in effect [would achieve] the same result by demanding the 'use value' of his collateral under § 362." To grant Associates the

equivalent of a security interest on the post-petition rents or Rash's own future personal services would be inconsistent with this Court's ruling in *Timbers*.

Associates is asking this Court to require Rash to pay extra for the continued use of the truck -- like the "use value" requested by the creditor in *Timbers*. If Rash were required to pay Associates for the use of the truck, the value of the secured claim would be -- as noted in *Timbers* -- an ever-increasing amount. In *Timbers*, at 630, this Court addressed the possibility of a secured claim that would increase in value over time and rejected the idea that Congress would have intended such a result.

D. THE PRE-CODE RULE SUPPORTS RASH'S POSITION

1. The "Bankruptcy Rule" When Liquidation Was the Only Generally Available Form of Bankruptcy Relief

While a bankruptcy debtor was able to propose composition reorganization plans as early as 1874, reorganizations were rare until the great depression of the 1930s. Before the 1930s, the generally available form of bankruptcy relief involved the liquidation of assets of the debtor.

In liquidation bankruptcies, estate assets were distributed pro-rata on unsecured claims. Secured creditors were only allowed to receive dividends from estate proceeds based upon the unsecured portions of their debt. In order to determine the unsecured portion, secured creditors were required to repossess and dispose of the secured collateral and account for the proceeds. This process of accounting for the actual proceeds of the collateral in determining the remaining unsecured claim was referred to as the "bankruptcy rule." The Bankruptcy Rule was the origin of the rule now applicable in Rash's case.

Applying old English and nineteenth century American bankruptcy law to Rash's case, Associates would not share in the dividends to creditors from the bankruptcy estate unless it recovered and sold Rash's truck and accounted for the proceeds.

The Bankruptcy Rule, part of the legal tradition over several centuries, has served the purpose of assuring that partially secured creditors do not receive a disproportionate percentage of the limited dividends available to creditors. The method of

valuing the secured portion of the claim under early liquidation bankruptcy proceedings was from the creditor's perspective, as proposed by Rash in this case.

2. The "Bankruptcy Rule" Applied in Reorganization Bankruptcies

Under bankruptcy reorganization provisions, the protection intended by the Bankruptcy Rule was expanded to include protection for the debtor as well as the general unsecured creditors, against secured creditors. Because of the massive numbers of foreclosures and business failures in the 1930s, Congress sought to improve and create new alternatives to liquidation bankruptcies. Equity reorganizations outside of bankruptcy were used as a starting point for creating new relief inside of bankruptcy.

In developing the concept of reorganization, Congress and the courts experimented with ways of compensating the secured creditors for their property interests consistent with the Fifth Amendment without requiring liquidation of the security. The goal of reorganization was to allow the debtor to reorganize by retaining its assets.

In developing a way of properly compensating the secured creditor to avoid a taking under the Fifth Amendment, the courts and Congress valued secured claims as described below, with each new step providing better protection of the creditor's property (security) interest. Over time, the amount the secured creditor was found to be entitled to realize developed, as follows: 1) first, set at the amount of an actual judicial sale of the security; 2) then set by an appraisal of the property to establish the amount expected at a judicial sale; 3) then set by allowing the creditor to bid in its full claim at a judicial sale; and 4) finally set at the expected net recovery by the creditor upon surrender of the security (which would be the maximum amount a partially secured creditor would be willing to bid in at a judicial sale of the security).

In 1934, Congress amended the 1898 Bankruptcy Act by enacting the Frazier-Lemke Act to provide for bankruptcy reorganizations. These new provisions were found to effect a taking in violation of the Fifth Amendment for two basic reasons: 1) the

creditor's property interest (security interest) was substantially impaired because foreclosure was prevented and the value of the security interest was to be established only by appraisal of the hypothetical judicial sale amount; and 2) the provisions were effective only retrospectively. It was held that a secured creditor could not be deprived of his right to a judicial sale. *Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555, 55 S.Ct. 854, 79-L.Ed. 1593 (1935), *Collier on Bankruptcy* (14th ed. 1977) Vol. 6A, ¶ 10.16.

Shortly thereafter, Congress enacted corrective legislation which allowed the partially secured creditor to bid in at any actual sale of the property -- up to the full amount of its claim -- regardless of the prior valuation by appraisal. This was thought to protect the creditor's property interest because it was assured the right to obtain the property for a bid of what it believed it could recover in its own disposition of the asset. This Court validated the amended Frazier-Lemke provisions in the two *Wright* cases: *Wright v. Vinton Branch of the Mountain Trust Bank*, 300 U.S. 440 (1937) and *Wright v. Union Central Life Insurance Co.*, 311 U.S. 273 (1940).

Valuation of a secured claim based upon an appraisal of hypothetical *judicial* sale proceeds became the logical result of protecting the creditor's property rights while allowing the debtor to retain the securing asset. The development of the concept of using appraisals to determine the hypothetical judicial sale value of securing assets is discussed in 6A *Collier on Bankruptcy* (14th ed. 1977) ¶ 10.16.

In 1938, Congress passed the Chandler Act which incorporated and improved some of the elements of equity receivership and prior amendments to the Bankruptcy Act, adding Chapters X, XI, XII, and XIII (a reorganization provision for individual wage-earners). Chapter X provided debtors with the most powerful provisions relating to the treatment of secured claims.

Valuation of secured claims under Chapter XIII was governed by Rule 13-307(d). With regard to that Rule, *Collier* explains: "the court may use any of the modes for determining the value of security specified in § 57h (*i.e.*, by converting the collateral into money according to the terms of the security

agreement ...)." *Collier on Bankruptcy* (14 ed. 1977), Vol. 15, ¶ 13-307.07-08. Here again, valuation of secured claims was viewed from the creditor's perspective.

Partially secured creditors preferred and promoted low secured claim valuations under the 1898 Bankruptcy Act and Bankruptcy Rule because they did not receive distributions on secured claims. They did, however, receive distributions on unsecured claims, and thus had an incentive to maximize the unsecured claim and minimize the secured claim. In the hands of partially secured creditors, low valuations of secured claims were accompanied by significant leverage as against the debtor which could force full repayment of the debt regardless of the secured claim valuation. The debtor enjoyed limited protection from the bankruptcy court with regard to secured claims.

E. LEGISLATIVE HISTORY OF THE 1978 BANKRUPTCY CODE SUPPORTS RASH'S POSITION

Under the Bankruptcy Act of 1898, as amended in 1938, secured creditors had both more powers and fewer rights than before the 1930s. The realization of Congress' objective to protect the substantive property rights of secured creditors yet allowing debtors to retain and use the security was imperfect, however. Many problems developed in the treatment of secured claims in the context of bankruptcy reorganizations. Some secured creditors could veto Chapter XIII plans by which they were essentially unaffected. In other cases, however, secured creditors were restrained from foreclosing on the security while also being prevented from collecting any payments. See *Report of the Commission on the Bankruptcy Laws of the United States*, H.R. Doc.No. 93-137, 93rd Cong., 1st Sess., Part I, p. 165-166, 174; Part II, p. 131, 207-208 (1973).

The Commission intended to: 1) assure secured creditors that the plan would either provide for the surrender of the security or equivalent compensation for the security; and 2) to prevent the secured creditor from vetoing such a Chapter 13 plan.

This Court has stated that in order to effect a major change to a pre-Code practice, the change would have to be "the subject of at least some discussion in the legislative history." *Dewsnup v.*

Timm, 502 U.S. 410, 112 S.Ct. 773, 779, 116 L.Ed.2d 903 (1992). Regarding Chapter 13 plans, the House Report states that an important change is in the treatment of secured creditors. 90 F.3d at 1056. The House Report "expresses an intent to protect the creditor's right to *realize* the value of its secured claim." The Report proceeds to discuss the change:

> "Current chapter XIII does little to recognize the differences between the *true value* of the goods and their *value as leverage*. Proposed chapter 13 instead views the secured creditor debtor relationship as a financial relationship, and not one where extraneous, non-financial pressures should enter." [Emphasis added]. H.R. Rep. No. 95-595, at 124

Responding to the problems experienced following the Chandler Act, Congress provided protections for both debtors and secured creditors in § 1325(a)(5) and § 506(a), enacted in 1978. Congress sought to assure that Chapter 13 debtors could retain their property, and also sought to assure payment to secured creditors of the value to them of their security interest. Congress gave no indication of an intent to change the traditional method of valuing secured claims from the creditor's perspective. Instead, the important change involved reducing the unfair leverage exercised by secured creditors in preventing the success of Chapter XIII.

Congress did not "write on a clean slate" in drafting § 506(a). It enacted § 506(a) incorporating with it the lengthy history of secured claim valuation practice dating back the Henry VIII, with no mention at any time of any intent to create a new method of valuing secured claims which would require the debtor to pay replacement value.

Portions of H.R. Rep. No. 95-595 discussed the treatment of secured claims. See 90 F.3d at 1055-1059. The Report stated (at 181):

> "Secured creditors have exercised great leverage by virtue of the uncertainty, and have made reorganization and individual repayment plans more difficult to consummate than would be the case under this bill."

In *Timbers*, supra, this Court cites this page (p. 181) of the

House Report in support of its statement that "the phrase 'value of such creditor's interest' in § 506(a) means 'the value of the collateral,'" at 630. In refusing to allow the creditor in *Timbers* payment for the "use value" of the property, this Court was implementing Congressional intent *not to* over-compensate partially secured creditors due to their leverage.

The legislative history of 11 U.S.C. § 361 also shows Congress' intent to continue the pre-Code rule regarding the valuation of secured claims. Both Senate and House Reports regarding the 1978 Code make clear Congress' intent to protect secured creditors against depreciation and waste so as to assure that they would realize the value of their security interest. See H.Rept. No. 95-595 to accompany H.R. 8200, 95th Cong., 1st Sess. (1977) pp. 338-340; S. Rep. No. 95-989 to accompany S. 2266, 95th Cong. 2d Sess. (1978), pp. 49, 53, 54.

Throughout the legislative history, the creditor's interest is repeatedly the focus of protection. Nowhere in the legislative history of § 361, § 506(a), § 1322, or § 1325, is there any reference to valuing secured claims based upon the benefit conferred on the debtor by the securing assets. The legislative history regarding § 361 provides clarification regarding the meaning of § 506(a) because in *Timbers* supra, this Court equates the phrase "value of such creditor's interest" in § 506(a) with "value of such entity's interest" in § 361(1) and (2).

F. CONGRESSIONAL ACTION SINCE THE ADOPTION OF THE 1978 BANKRUPTCY CODE SUPPORTS RASH'S POSITION

In 1981, the Senate Judiciary Subcommittee on Courts held hearings on the Bankruptcy Code. Within a period of fourteen months, two separate bills were introduced [S. 2000 (1981) and S. 445 (1983)], both of which included an amendment to § 506(a) that would have codified the use of retail value for the purpose of valuation under § 1325(a)(5)(B). Both times these amendments were rejected. See *Collier on Bankruptcy*, ¶ 506.03 at 506-13 to 506-14 (15th ed. 1996).

By the early 1980s, partially secured creditors had discovered that under the Bankruptcy Code they no longer had the

leverage to enforce full payment on their debts and in response, a creditor initiative was launched to have Congress ratify a new "intent" regarding the valuation of secured claims. The attempt failed. Congress repeatedly refused to adopt this language.

Associates should not be allowed to use the courts to effect a revision to the Bankruptcy Code which had previously been considered and rejected by Congress. See *Bennett v. Kentucky Dept. of Education*, 470 U.S. 656, 665 at n. 3, 105 S.Ct. 1544, 84 L.Ed.2d 590 (1985) (rejection of an amendment by a later Congress has persuasive value when construing a statute); *New York Telephone Co v. New York Dept. of Labor*, 440 U.S. 519, 544 at n. 44, 99 S.Ct. 1328, 59 L.Ed.2d 553 (1979) (repeated rejection of a position by Congress considered in construing a statute).

When a particular statutory interpretation has been explicitly brought to the attention of Congress, as here, and where Congress has not sought to alter that interpretation despite amending the statute in other respects, then "presumably the legislative intent has been correctly discerned." See *North Haven Board of Education v. Bell*, 456 U.S. 512, 535, 102 S.Ct. 1912, 72 L.Ed.2d 299 (1982) quoting *Apex Hosiery Co. v. Leader*, 310 U.S. 469, 489, 60 S.Ct. 982, 84 L.Ed. 1311 (1940).

G. RASH'S PLAN MEETS THE GOOD FAITH REQUIREMENT OF § 1325(a)(3)

Associates fears that a decision of this Court upholding the *en banc* Fifth Circuit opinion will result in debtor abuse of the cram down right. Pet. Brief 37-38. Associates fails to consider that pursuant to § 1322 the debtor's Chapter 13 plan must be proposed in "good faith" in order to be confirmed by the bankruptcy court. If a debtor purchases and finances a vehicle while intending to immediately file Chapter 13, the creditor can object to plan confirmation on the basis of the debtor's lack of "good faith." The present law was carefully written to provide protections for creditors in just such a situation. Creditors in general do not hesitate to object to plan confirmation if they believe the debtor has sought Chapter 13 relief in "bad faith."

Rash filed his Chapter 13 plan in "good faith" after having made a substantial down payment on the purchase price and

having made nearly three years of monthly payments on Associates' loan. 90 F.3d at 1038-1039.

H. RASH'S CRAM DOWN OF ASSOCIATES' CLAIM IS NOT A "TAKING" OF A PROPERTY INTEREST

In *Wright v. Vinton Branch*, supra, *Wright v. Union Central Life*, supra, and *In Kuehner v. Irving Trust Co.*, 299 U.S. 445, 57 S.Ct. 298, 81 L.Ed. 340 (1937), this Court allowed the modification of contract rights of secured creditors while still protecting their property rights in bankruptcy reorganizations. More recently, this Court found household goods lien avoidance pursuant to 11 U.S.C. § 522(f) (not applicable in the case *sub judice*) in *U.S. v. Security Industrial Bank et al.*, 459 U.S. 70, 103 S.Ct. 407, 74 L.Ed.2d 235 (1982) to be a permissible modification and impairment of the secured creditor's rights.

Under § 1325, the amount of money recovered on the contract is reduced to the net value of the creditor's property interest and the creditor retains its lien until the secured claim is fully paid. The creditor also holds an unsecured claim for any deficiency. While the creditor is not allowed to repossess the security, the creditor is being fully compensated for its property interest because it is being paid the amount it would have recovered had it repossessed and disposed of the security (the amount of the secured claim). And although the creditor is not allowed to *immediately* realize the expected net recovery on repossession and disposition, the creditor is fully compensated for the delay in payments by receiving additional payments above and beyond the secured claim amount -- the "time-value of money." In fact, pursuant to protections provided by § 1325(a)(5), the creditor's property interest is completely intact. If the case is dismissed, the creditor can repossess pursuant to non-bankruptcy law based upon the lien it has retained.

I. PRACTICAL PROBLEMS WITH ASSOCIATES' POSITION

Associates proposes that this Court adopt valuation standards that vary with the market in which the goods are normally sold. Pet. Brief 22. Under Associates' view, assets which are

"typically purchased from a retailer" should be valued at "retail" value, while used household goods could be valued at prices obtained in "flea markets, rummage sales, or through classified advertisements ... ."

Associates continues: "if the debtor is a retailer who buys for resale at wholesale prices, the relevant market is the wholesale market, and wholesale value would be proper." Pet. Brief 22. Why Congress would prefer a debtor, simply because he is a retailer, by giving him a lower secured claim valuation is hard to understand. Associates then proposes that a consumer-debtor should pay a higher secured claim based upon retail valuation. In neither of these cases is the partially secured creditor's property interest (security interest) being valued so that it can be paid through the Chapter 13 plan. Why would Congress have intended a car-dealer debtor to pay a lower secured claim on a car loan than a normal consumer debtor? Not only is this result puzzling, but it contradicts the explicit intent of Congress to allow consumer debtors to retain their assets in exchange for compensating the creditor for its security interest. While "retail" value for vehicles would benefit Associates, this proposal lacks any support in the statutory language, legislative history, or pre-Code rule.

Section 506(a) does not call for the simple valuation of the property which secures the claim. What is to be valued is more complex -- the creditor's interest in the estate's interest in that property. Furthermore, § 506(a) does not call for valuation of the property serving as security *in the hands of a car dealer*, from the point of view of either a car dealer buying or selling the vehicle.

Valuing the secured claim at "retail" would grant a windfall to the secured creditor not contemplated in either bankruptcy or non-bankruptcy law. Nor is retail value equivalent to the replacement value of the collateral. A debtor may replace a vehicle by purchasing one from a car dealer at retail value, or the debtor may replace it by purchasing one from a neighbor, relative, or through classified advertisement, for significantly less than a dealer would charge. A debtor could even purchase a vehicle at an auction of repossessed vehicles.

Associates' claim that replacement value to the debtor is the value of the truck to the debtor (Pet. Brief 22) neglects the equitable interest Rash owns in the truck. The debt owed by Rash exceeds the value of the truck, and therefore Rash does not have any monetary equity in the truck. But, Rash does own an *equitable* interest in the truck, and he has the right to continued possession and use of it while under the protection of the Bankruptcy Court. This equitable interest owned by Rash results from his trade-in of a prior truck, his monthly payments made to Associates directly before filing the Chapter 13 petition, and monetary investments by Rash in maintaining and insuring the vehicle. Rash's equitable interest in his truck would be completely taken from him if Associates prevails in this case.

Furthermore, the value of the property to the debtor is its "use value" -- which does not necessarily equal the cost to replace the item by the debtor. For example, a measure of the value of the vehicle to the debtor is the future income produced by the debtor as a result of keeping the security. In the case *sub judice*, by keeping the truck Rash is able to continue working as a truck driver. Yet, the income he produces (reflected in the lease payments to Rash) more clearly relates to the post-petition personal services he performs as a truck driver and which should not cause the secured claim of the creditor to increase.

In most Chapter 13 cases, debtors use their vehicles primarily for transportation to and from work, and do not use the vehicles to produce income directly. It could be argued that the value of the vehicle in this situation is rental value of the vehicle for each month it is used by the debtor post-petition. As pointed out by this Court in *Timbers*, at 630, to value the secured claim based upon an ever-increasing amount such as "rental cost" or "stream of payments" is not likely to have been the Congressional intent.

Any proposal that would adopt "book" value for vehicles would be fraught with problems. Numerous valuation books are published with attendant variations in prices. Usually only one of them is commonly used in any particular area. Accordingly, the use of "books" will create different values for same car and same lender in different locations.

An adoption of "book" valuation completely ignores the

language of § 506(a) because it values the vehicle from the point of view of a car dealer. Low book is normally defined as the price a dealer would pay for the vehicle, and high book is normally the price at which the dealer would sell the vehicle. Mid-book has no statutory basis either; it is simply a way some courts have found to avoid "unfairness" to either party. In addition, the proposal of a book-based valuation standard completely ignore the fact that there are many types of property for which there are no "books".

On the other hand, implementation of the Fifth Circuit's decision would be easily accomplished. As can be imagined, consumer debtors do not have the financial capacity to litigate valuation issues on a case-by-case basis. Inevitably, regional shortcuts will be developed which will approximate, for each lender, its estimated recovery on repossessions. Simple statistical analysis could show that a lender typically recovers an average percentage on repossession. For example, a quick review of complaints for deficiency judgments under state law filed by the lender in each area would be a way of determining its recovery. That value could be expressed as a percentage of the vehicle valuation publication used in that area. Debtors will likely agree to such an approximation of the expected net recovery by the lender as a practical mechanism for establishing vehicle valuations pursuant to § 1325(a)(5)(B).

VIII. CONCLUSION

In conclusion, NACBA does not find either § 506(a) or § 1325(a)(5)(B) to be ambiguous. However, if this Court finds ambiguity, this Court has specifically considered possible statutory ambiguity with regard to the competing interests of a partially secured creditor and a bankruptcy reorganization debtor in *Wright v. Union Central Life Insurance Co.*, 311 U.S. 273 (1940). At 278-281, this Court held that:

> Safeguards were provided to protect the rights of secured creditors, throughout the proceedings, to the extent of the value of the property. ... There is no constitutional claim of

the creditor to more than that. And so long as that right is protected the creditor certainly is in no position to insist that doubts or ambiguities in the Act be resolved in its favor and against the debtor. Rather, the Act must be liberally construed to give the debtor the full measure of the relief afforded by Congress ... lest its benefits be frittered away by narrow formalistic interpretations which disregard the spirit and the letter of the Act. ... Under our construction, however, the debtor will be given the benefit of an express mandate of the Act. And the creditor will not be deprived of the assurance that the value of the property will be devoted to the payment of its claim. ... Such an important remedial right [fundamental statutory right to redeem at the reappraised value or at the value fixed by the court] cannot be lost by mere implication. And to hold that the court has the discretion to deny or to grant the debtor's right to redeem ... dependent on general equitable considerations, would be to rewrite the Act, so as to vest in the court a power which Congress did not plainly delegate."

Amicus urges this Court to affirm in its entirety the excellent opinion of the Fifth Circuit *en banc*.

Dated: March 26, 1997 Respectfully submitted,

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APPENDIX

1898 Bankruptcy Act

11 U.S.C. Chapter 10, § 616. A plan of reorganization under this chapter --

(1) shall include in respect to creditors generally or some class of them, secured or unsecured, and may include in respect to stockholders generally or some class of them, provisions altering or modifying their rights, either through the issuance of new securities of any character or otherwise;

...

(10) shall provide adequate means for the execution of the plan, which may include: the retention by the debtor of all or any part of its property; the sale or transfer of all or any part of its property to one or more other corporations theretofore organized or thereafter to be organized; the merger or consolidation of the debtor with one or more other corporations; the sale of all or any part of its property, either subject to or free from any lien, at not less than a fair upset price and the distribution of all or any assets, or the proceeds derived from the sale thereof, among those having an interest therein; the satisfaction or modification of liens; the cancelation [sic] or modification of indentures or of other similar instruments; the curing or waiver of defaults; the extension of maturity dates and changes in interest rates and other terms of outstanding securities; the amendment of the charter of the debtor; the issuance of securities of the debtor or such other corporations for cash, for property, in exchange for existing securities, in satisfaction of claims or stock or for other appropriate purposes;

....

1978 Bankruptcy Code

11 U.S.C. § 361. Adequate protection. When adequate protection is required under section 362, 363, or 364 of this title

of an interest of an entity in property, such adequate protection may be provided by-

(1) requiring the trustee to make a cash payment or periodic cash payments to such entity, to the extent that the stay under section 362 of this title, use, sale, or lease under section 363 of this title, or any grant of a lien under section 364 of this title results in a decrease in the value of such entity's interest in such property;

(2) providing to such entity an additional or replacement lien to the extent that such stay, use, sale, lease, or grant results in a decrease in the value of such entity's interest in such property; or

(3) granting such other relief, other than entitling such entity to compensation allowable under section 503(b)(1) of this title as an administrative expense, as will result in the realization by such entity of the indubitable equivalent of such entity's interest in such property.

11 U.S.C. § 506. Determination of secured status.

(a) An allowed claim of a creditor secured by a lien on property in which the estate has an interest, or that is subject to setoff under section 553 of this title, is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property, or to the extent of the amount subject to setoff, as the case may be, and is an unsecured claim to the extent that the value of such creditor's interest or the amount so subject to setoff is less than the amount of such allowed claim. Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor's interest.

(b) To the extent that an allowed secured claim is secured by property the value of which, after any recovery under subsection (c) of this section, is greater than the amount of such claim, there shall be allowed to the holder of such claim, interest on such claim, and any reasonable fees, costs, or charges provided for under the agreement under which such claim arose.

(c) The trustee may recover from property securing an allowed secured claim the reasonable, necessary costs and expenses of preserving, or disposing of, such property to the extent of any benefit to the holder of such claim.

(d) To the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void unless-

(1) such claim was disallowed only under section 502(b)(5) or 502(e) of this title; or

(2) such claim is not an allowed secured claim due only to the failure of any entity to file a proof of such claim under section 501 of this title.

11 U.S.C. § 1322. Contents of plan.

(a) The plan shall-

(1) provide for the submission of all or such portion of future earnings or other future income of the debtor to the supervision and control of the trustee as is necessary for the execution of the plan;

(2) provide for the full payment, in deferred cash payments, of all claims entitled to priority under section 507 of this title, unless the holder of a particular claim agrees to a different treatment of such claim; and

(3) if the plan classifies claims, provide the same treatment for each claim within a particular class.

(b) Subject to subsections (a) and (c) of this section, the plan may-

(1) designate a class or classes of unsecured claims, as provided in section 1122 of this title, but may not discriminate unfairly against any class so designated, however, such plan may treat claims for a consumer debt of the debtor if an individual is liable on such consumer debt with the debtor differently than other unsecured claims;

(2) modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor's principal residence, or of holders of unsecured claims, or leave unaffected the rights of holders of any class of claims;

(3) provide for the curing or waiving of any default;

(4) provide for payments on any unsecured claim to be made concurrently with payments on any secured claim or any other unsecured claim;

(5) notwithstanding paragraph (2) of this subsection, provide for the curing of any default within a reasonable time and maintenance of payments while the case is pending on any unsecured claim or secured claim on which the last payment is due after the date on which the final payment under the plan is due;

(6) provide for the payment of all or any part of any claim allowed under section 1305 of this title;

(7) subject to section 365 of this title, provide for the assumption, rejection, or assignment of any executory contract or unexpired lease of the debtor not previously rejected under such section;

(8) provide for the payment of all or part of a claim against the debtor from property of the estate or property of the debtor;

(9) provide for the vesting of property of the estate, on confirmation of the plan or at a later time, in the debtor or in any other entity; and

(10) include any other appropriate provision not inconsistent with this title.

(c) Notwithstanding subsection (b)(2) and applicable nonbankruptcy law-

(1) a default with respect to, or that gave rise to, a lien on the debtor's principal residence may be cured under paragraph (3) or (5) of subsection (b) until such residence is sold at a foreclosure sale that is conducted in accordance with applicable nonbankruptcy law; and

(2) in a case in which the last payment on the original payment schedule for a claim secured only by a security interest in real property that is the debtor's principal residence is due before the date on which the final payment under the plan is due, the plan may provide for the payment of the claim as modified pursuant to section 1325(a)(5) of this title.

(d) The plan may not provide for payments over a period

that is longer than three years, unless the court, for cause, approves a longer period, but the court may not approve a period that is longer than five years.

(e) Notwithstanding subsection (b)(2) of this section and sections 506(b) and 1325(a)(5) of this title, if it is proposed in a plan to cure a default, the amount necessary to cure the default [SIC] shall be determined in accordance with the underlying agreement and applicable nonbankruptcy law.

11 U.S.C. § 1325. Confirmation of plan.

(a) Except as provided in subsection (b), the court shall confirm a plan if-

(1) the plan complies with the provisions of this chapter and with the other applicable provisions of this title;

(2) any fee, charge, or amount required under chapter 123 of title 28, or by the plan, to be paid before confirmation, has been paid;

(3) the plan has been proposed in good faith and not by any means forbidden by law;

(4) the value, as of the effective date of the plan, of property to be distributed under the plan on account of each allowed unsecured claim is not less than the amount that would be paid on such claim if the estate of the debtor were liquidated under chapter 7 of this title on such date;

(5) with respect to each allowed secured claim provided for by the plan-

(A) the holder of such claim has accepted the plan;

(B) (i) the plan provides that the holder of such claim retain the lien securing such claim; and

(ii) the value, as of the effective date of the plan, of property to be distributed under the plan on account of such claim is not less than the allowed amount of such claim; or

(C) the debtor surrenders the property securing such claim to such holder; and

(6) the debtor will be able to make all payments under the plan and to comply with the plan.

(b) (1) If the trustee or the holder of an allowed unsecured

claim objects to the confirmation of the plan, then the court may not approve the plan unless, as of the effective date of the plan-

(A) the value of the property to be distributed under the plan on account of such claim is not less than the amount of such claim; or

(B) the plan provides that all of the debtor's projected disposable income to be received in the three-year period beginning on the date that the first payment is due under the plan will be applied to make payments under the plan.

(2) For purposes of this subsection, "disposable income" means income which is received by the debtor and which is not reasonably necessary to be expended-

(A) for the maintenance or support of the debtor or a dependent of the debtor; and

(B) if the debtor is engaged in business, for the payment of expenditures necessary for the continuation, preservation, and operation of such business.

(c) After confirmation of a plan, the court may order any entity from whom the debtor receives income to pay all or any part of such income to the trustee.